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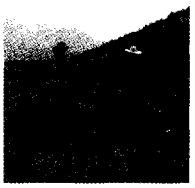

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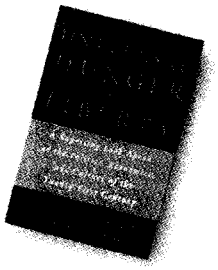

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From the President

The European Union and the Interventionist State

BY RICHARD M. EBELING

According to a public-opinion survey released in January, almost nine out of every ten citizens of European Union (EU) member nations know either little or nothing of the draft constitution for Europe, which would further centralize political power and control over their lives. Yet in spite of this pervasive ignorance, 49 percent said they favor the constitution. Only 16 percent expressed their opposition.

The poll was taken on behalf of the EU Commission last fall. While 11 percent of the respondents said they consider themselves generally knowledgeable of the content of the proposed constitution, 56 percent said they know very little about it. And of the 33 percent who admitted they had never even heard about the constitution, 22 percent still said they favor it!

The EU grew out of attempts that began in the 1950s to establish a free-trade zone among a number of western European countries, both to improve their prosperity and to reduce the potential for conflict after the experiences of the two world wars. It formally became the European Economic Community (EEC) with the Treaty of Rome in 1957. But soon the free-trade idea was superseded by various interventionist programs for intergovernmental planning of agriculture and industry, and for a welfare-state social safety net.

The EEC was transformed into the EU in 1992, with additional plans for a single currency, which finally came to fruition with the establishment of the euro as a circulating currency in 2002. In 2000 a conference was held in Nice, France, to plan the expansion of the EU to incorporate many new member states in central and eastern Europe, as well as to determine voting procedures in the expanded EU. Then in October 2004, at a conference in Rome, the EU members agreed to a draft constitution that is meant to lead to a more integrated political regime and eventually a United States of Europe.

Over the next two years, votes will be taken among the member nations to ratify the proposed constitution. In some countries the decision will be made by the parliament; in others, by referendum. The constitution will only go into effect if the EU countries unanimously agree to it.

Central to the proposed constitution is a charter of "fundamental rights." Many are consistent with the principles of liberty, including a ban on torture and inhumane or degrading punishment, and a prohibition on slavery and involuntary servitude. It also affirms freedom of speech, assembly, and religion, along with impartial justice under the rule of law. In addition, it promises freedom of movement, including the right of residence and work for any citizen within the territory of the EU (though some member countries wish to establish certain limits on this freedom).

But the proposed EU constitution also incorporates among its "fundamental rights" an entire array of welfare-state entitlements. Every citizen will be guaranteed "free and compulsory education." Every citizen is promised "freedom to conduct a business," but "the use of property may be regulated insofar as it is necessary for the general interest."

While the constitution speaks of "freedom of association at all levels," any private discrimination "on the basis of sex, race, ethnic or social origin, genetic features, language, religion or belief, political or other opinion, membership of a national minority, property, birth, disability, or sexual orientation shall be prohibited." Employers must also provide "equality between men and women," including in "employment, work, and pay." But EU governments may discriminate through affirmative-action laws "for specific advantages in favor of the under-represented sex."

Under the "fundamental rights" of employment,

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"every worker has the right to working conditions which respect his or her health, safety, and dignity." Every worker in the EU is also to be guaranteed a paid vacation ("an annual period of paid leave") as well maternity and paternity leave. Nor may a worker be dismissed without a prolonged legal procedure.

Elderly people are to be guaranteed a "life of dignity and independence, and to participate in social and cultural life." All EU citizens are to have "the entitlement to social security benefits and social services providing protection in cases such as maternity, illness, industrial accidents, dependency, or old age, and the case of loss of employment." Also guaranteed by the constitution is "the right to social and housing assistance so as to assure a decent existence for all those who lack sufficient resources," as well as "the right of access to preventative health care and the right to benefit from medical treatment."

Centralized Power

The proposed constitution also contains a lengthy section on economic relations among the member countries. On the surface much of what is promulgated would seem to be consistent with a vast free-trade zone incorporating much of the European continent. Indeed, under the EU constitutional rules there would be established a wide degree of freedom of movement, occupation, capital investment and transfer, and financial mobility. And none of this should be undervalued as an important improvement for the economic well-being of the people of Europe as a whole.

But a closer reading of the constitution's clauses makes it clear that over time a growing amount of responsibility and control would be shifted away from the member nations to the centralized EU authority and bureaucracy in Brussels. Taxing policies and regulations would be "harmonized," meaning less opportunity for individual governments to take advantage of having lower taxes than their neighbors. "Competition policy" would see the concentration of interventionist rules in the hands of the European-wide regulatory agencies; this would keep individual governments from loosening or eliminating restrictions on the freedom of enterprise within their own countries. Brussels would end up establishing a "floor" for all of Europe below which no one country would be able to reduce state control over the economy.

The EU economic regulations under the constitution would also impose all the currently "politically correct" conceptions about environmental regulation. The constitution would end up establishing European-wide labor-law standards and controls that would make it more difficult or impossible for individual member states to reduce anti-market restrictions on wages and work conditions.

What Europe is moving towards therefore is a constitutional institutionalization of the interventionist-welfare state. If the citizens of one member country saw the benefits of following a more laissez-faire set of policies, they would be unable to take such a course of action unless they were able to persuade a majority of the other member governments to go along with it.

All social and economic policy-making would slowly but surely be monopolized in the central EU administration. Local control and decision-making would be drained away from levels of government closest to the people and moved to Brussels, where a vast and unaccountable bureaucracy has already been usurping powers previously in the hands of member governments.

Unfortunately, it is doubtful whether a majority of the people in the EU would oppose this trend even if they were more informed about the content of the proposed constitution. Of the 11 percent who said they are knowledgeable about it, 75 percent said they favor it; and of the 56 percent who stated they know very little about the constitution's content, 60 percent said they support it.

It seems that the interventionist-welfare state is desired by the vast majority of Europeans, regardless of what level of government imposes it. Freedom, especially economic liberty, apparently has a very low priority in the cradle of Western Civilization.

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Perspective

Bad Is Not Good

Youthful exponents of the freedom philosophy sometimes believe that things will get better politically only if they first get worse. As statism brings its inevitable hardships, people will correctly identify the causes of their adversity and demand a rollback of government power.

The Russian Revolution, which grew out of a miserable war, seems to support the theory that bad can lead to revolutionary change. But there's one hitch. The Bolsheviks sought an increase in state power. Libertarians seek a vast reduction. That a crisis can lead to socialism—indeed, totalitarianism—is no evidence that it can lead to capitalism.

We're reminded of this by an economist at George Mason University, and an old friend, Bryan Caplan. In his article "The Idea Trap" (www.econlib.org/library/Columns/y2004/Caplanidea.html), Caplan writes, "A society can get stuck in an 'idea trap,' where bad ideas lead to bad policy, bad policy leads to bad growth, and bad growth cements bad ideas. Once you fall into this trap, all it often takes is common sense to get out. But when people are desperate, common sense gets even less common than usual."

For Caplan, this explains why many countries never shed their growth-inhibiting policies for privatization and deregulation: "The connection between growth and ideas is not so much logical as *psychological*. It is not logical for people to embrace counter-productive ideas just because conditions are getting worse, but they seem to do it anyway. Perhaps the best explanation is that the public relies on a military metaphor: You should avoid aggressive government intervention in good times, but during a crisis, you need to teach your enemies a lesson, not waste time soul-searching about how you provoked them."

Ludwig von Mises and Joseph Schumpeter, Caplan notes, were skeptical that bad will lead to good. As Mises wrote, "Popular opinion ascribes all these evils to the capitalistic system. As a remedy for the undesirable effects of interventionism they ask for still more interventionism." Mises offered further support for the "idea trap" in his book A *Critique of Interventionism*, in which he showed how the harms

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from government control of the economy could lead to further controls rather than economic freedom.

Freeman columnist Roberts Higgs has added to our theoretical and empirical knowledge of such things in his classic work, *Crisis and Leviathan*. In that book he showed that the crises born of war and depression tend to lead to more intrusive government, not demands for liberal reform.

Alexis de Tocqueville is famously associated with a logical corollary of the "idea trap," the theory of the revolution of rising expectations, namely, that improvement begets improvement. In *The Old Regime and the Revolution*, Tocqueville wrote: "Generally speaking, the most perilous moment for a bad government is one when it seeks to mend its ways. Patiently endured so long as it seemed beyond redress, a grievance comes to appear intolerable once the possibility of removing it crosses men's minds. For the mere fact that certain abuses have been remedied draws attention to the others and they now appear more galling; people may suffer less, but their sensibility is exacerbated."

But that prompts this question: what brings the initial improvement? Caplan responds: "The answer, in my model, is *luck*. An economy in the idea trap usually stays in the idea trap. But once in a while, it wins a little lottery. Maybe the president of the country happens to read Bastiat during his last term, and decides to try a more free-market approach. This increases growth, which in turn improves the climate of public opinion."

From all this, Caplan concludes, "[A]dvocates of free-market reforms should always root for good times and marginal improvements."

But marginal improvements within a rich but interventionist culture may merely instill an "if it ain't broke, don't fix it" mentality. Good times may be necessary for increasing freedom and prosperity, but they may not be sufficient. Economic and an even broader philosophical understanding appear necessary too. Luck isn't enough.

* * *

The opponents of unfettered world trade routinely pose as champions of the poor in the less-developed parts of the world. The irony, Steven Horwitz shows, is that free trade is indispensable to the escape from poverty.

Whatever happened to the Great Outsourcing Scare of 2004? It disappeared as quickly as it emerged. Jude Blanchette explains that there was never anything to fear.

For the critics of capitalism, almost anything qualifies as proof that the system is morally flawed. The recent corporate scandals thus created a feeding frenzy for those who would give the government more supervision over peaceful commerce. But Norman Barry demonstrates that, if anything, those scandals indicate the need for deregulation of the marketplace.

The great Austrian economist Ludwig von Mises came of age in a remarkable place during a remarkable time. In the first of a two-part article, Richard Ebeling paints a portrait of late-nineteenth-century Vienna.

All you have to do is read the newspapers to see that government is running amok with the power of eminent domain. Steven Greenhut presents a revealing case study.

The modern social sciences are enamored with theoretical models, those elegant abstract edifices that our untidy real world never manages to equal. Do those models help us understand social and economic processes? Or are they traps to justify government intervention? Gene Callahan and Robert Murphy answer these questions.

Here's what our columnists' labor has yielded for this issue: Richard Ebeling examines the proposed European Union constitution. Lawrence Reed relates a near-horror story from Detroit. Thomas Szasz unmasks Benjamin Rush. Robert Higgs reports on how cattlemen generated property rights. Charles Baird continues his discussion of Henry Hazlitt's views on labor unions. And your editor, reading a prominent columnist's case for government funding of science, remonstrates, "It Just Ain't So!"

Our book reviewers take on volumes about the yearning for freedom, Franklin Roosevelt, the climate in academia, and education historian E. G. West.

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Government Should Fund Science? It Just Ain't So!

BY SHELDON RICHMAN

Thomas Friedman, the *New York Times* foreign-affairs columnist, is beside himself because the 2005 federal budget contains a 2 percent, or $105 million, cut for the National Science Foundation (NSF). As W. S. Gilbert would say, "Oh, horror!" This, Friedman predicted in his December 5, 2004, column ("Fly Me to the Moon"), will condemn us Americans to a bleak future indeed. In support he enlists Shirley Ann Jackson, president of the American Association for the Advancement of Science. Not coincidentally, this organization is populated by the collectors of innumerable NSF grants. Not everything a scientist says is objective.

Would it be too much to expect one of the country's most prominent journalists to do a little historical digging? Friedman might have discovered substantial scientific and medical projects undertaken and successfully completed by privately funded interests. As Aaron Steelman wrote in these pages over six years ago, "[T]he private sector has been responsible for some of mankind's most important scientific breakthroughs" ("The Free Market and Scientific Research," May 1998, www.fee.org/vnews.php?nid=4017). Steelman went on to document his assertion with cases such as the discovery of a smallpox vaccine, diphtheria antitoxin, DNA, the genetic structure of viruses, the practical application of penicillin, and more. Private money, such as that provided by the Rockefeller Foundation, made this heroic work possible.

If Friedman's point is that *fewer* projects would be funded, how does he know that *too many* aren't being funded now?

Folks like Friedman take it for granted that only the government will undertake large-scale scientific ventures. But where does the government get the money? All government can do is take wealth from those who produced it and give it to those who didn't. The stock answer is that private investors won't finance "basic research" because it's not profitable in the short run. What this really means is that politicians and bureaucrats can be counted on to see the benefits of basic research more objectively than entrepreneurs. I'd like to see Friedman say that with a straight face.

As Public Choice economics teaches, we are far safer in presuming that politicians and bureaucrats are motivated by re-election and career enhancement than by a desire to benefit people who must finance government activities whether they like them or not. Political officials are apt to look only at the immediate benefits to highly visible and well-organized constituencies, and not at the larger expense spread thinly over the rest of society.

Entrepreneurs, on the other hand, earn profits only by anticipating what people will find beneficial and be willing to pay for. They must take costs into account and have no taxpayers at their disposal. (A real free market has no corporate welfare.) Businessmen routinely project their plans years ahead, without the prospect of an immediate payoff, if an attractive return is anticipated later. Entrepreneurs are capable of grasping that basic research will yield valuable products. Could it be that Friedman fears that his favorite projects won't be chosen?

Many people *believe* that the billions Congress has spent on the space program couldn't possibly have been put to better use. But how do they *know* that?

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They have no idea what would have been discovered and produced had the money been left in the private sector, where consumer sovereignty, free exchange, and the price system create the indispensable feedback lacking in the political system.

Boards full of unaccountable political appointees spending other people's money do not inspire confidence. *Innovation* and *bureaucracy* are words rarely found together in affirmative sentences. Knowledge is discovered through competition, but government centralization of research stifles competition. The authorities are not interested in funding what they regard as outside the mainstream. Moreover, government financing reduces private financing and even influences its direction. Political Correctness aggravates the problem many times over. The last thing we should want is the corrupting hand of bureaucracy bending the scientific enterprise. (See Kent Jeffreys, "Super Boondoggle: Time to Pull the Plug on the Superconducting Super Collider," Cato Briefing Papers No. 16, May 26, 1992, www.cato.org/pub_display.php?pub_id=1457&print=Y&full=1.)

Pervasive Collectivism

What is most disturbing about Friedman's article is its pervasive collectivism. It is not enough for him to argue that if the government doesn't finance scientific research, it won't get done. No, he commends massive government spending on science as a way to enlist Americans in a common cause. He writes that "a national science project . . . would be our generation's moon shot: a crash science initiative for alternative energy and conservation to make America energy-independent in 10 years. Imagine if every American kid, in every school, were galvanized around such a vision."

I could point out that the free market, if allowed to work, has a built-in incentive to develop alternative energies and conservation when they are needed: the quest for profit. I could also ask what energy independence would mean in a globalized world, which Friedman favors. But what I really need to ask is this: why would we want to galvanize every American kid around Friedman's vision? Do we want young people to look to a central authority for their mission in life?

He writes further that such a project "would also create a magnet to inspire young people to contribute to . . . America's future by becoming scientists, engineers and mathematicians."

Is Friedman not aware that when people pursue income and professional satisfaction they are led as if by an invisible hand to "contribute to America's future," if by that we mean the well-being of Americans (and others, of course)? Many of them will become scientists, engineers, and mathematicians not because the government has herded them in that direction, but rather because they love the work and like the compensation. If the problem is science and math education, then the solution has been available all along: separation of school and state.

Friedman calls on President Bush to "Summon . . . all our energies and skills to produce a 21st-century fuel." *All* our energies and skills? What does he have in mind for those who wish to work or invest in other areas of human need?

Of course, he has the obligatory quotation from President Kennedy, one of the great champions of national goal-setting: "We choose to go to the moon in this decade . . . because that goal will serve to organize and measure the best of our energies and skills." Friedman commends this attitude to President Bush, but after SpaceShipOne, the successfully launched, privately financed spacecraft, invoking the centralized and obscenely wasteful space program that Kennedy inspired sounds ignorant to say the least.

At any rate, why would we want *government* to organize our energies and skills? America is nothing if not a monument to the organizational prowess of the liberal market order. Look around and you'll see that there's no order like unplanned order. No government has ever achieved anything like what free people have achieved. And unlike government, which does its organizing by threatening violence against the innocent, the free market achieves its wonders through consent, contract, and incentive.

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Free Trade and the Climb Out of Poverty

BY STEVEN HORWITZ

Over the thousands of years of human history, poverty and early death have been the norm, with comfort and longevity the exceptions. The improvements in the human condition, at least on average, seen over the course of the twentieth century dwarf the improvements of the previous centuries combined. By virtually any measure one can imagine, human beings are living longer, better lives than at any other time. However, the wonders of the last century certainly did not touch all humanity equally. The clear majority of the world's population, though better off than 100 years earlier, still have lives a far cry from those of even the poorest in the West and North. One of the most pressing questions of this century is how we can extend the bounty of last century to those who have not yet been able to enjoy fully the fruits of human improvement.

At center stage in the debate over this issue is the role of "free trade" in generating or retarding human improvement. The concern, and protests in the streets, over "globalization" reflect the perceived centrality of international economic activity in understanding what makes people better off. As trade across national borders continues to grow, there are those who see in that growth the attempt by Western corporations and quasigovernmental institutions such as the International Monetary Fund (IMF) and World Bank to extract resources from the rest of the world for their own use, leaving those who already have a long hill to climb even farther from the top.

In addition, recent "free trade" agreements like NAFTA and the proposed FTAA (Free Trade Area of the Americas) complicate matters even more by simultaneously opening up trade and heavily regulating the trade now opened. Critics of free trade and so-called "profit-led" globalization are sometimes correct in pointing to the harmful effects of the IMF and World Bank, and the clear corporate special interests that are embodied in particular agreements. However, when those criticisms are extended to genuine free trade rightly understood, they miss the mark. Attempts to restrict such trade, or to "direct it from below," are bound to worsen the condition of those people who can afford it least. Although free trade is not sufficient to ensure economic and social well-being, it is a necessary means to that end.

The key to free trade's liberating role is that those who possess capital are able to bring it to workers who lack it, which in turn raises their productivity and enhances their earning power. Underlying the argument for free trade is the principle of comparative advantage, which argues that all parties are better off when each producer does what he or she does *comparatively* best and trades the results with others. Specialization by comparative advantage enables each person, or state/province, or country to find what they do at least cost and to benefit from the ability to exchange for what others can produce cheaply. Just as it makes more sense for me to specialize at being a college professor and trade for my food, clothing, and housing (rather than making them myself), it makes no sense to struggle to grow citrus in the American Midwest, when residents of those states can grow grain much more cheaply and trade for citrus with Florida, which has the comparative advantage at the latter.

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The same principles apply across nations. When individuals are free to trade across national boundaries, producers in each area will specialize in the things they can do most cheaply, to the benefit of themselves and their trading partners.

For many Third World countries, their comparative advantage is the cheapness of their labor and the availability of some natural resources. For Western firms, this presents an opportunity for profit by reducing labor and resource costs. When Western firms open up shop in the Third World, they bring capital to those places. This creates jobs for citizens there and provides the West with cheaper goods. It is the classic mutual benefit of all exchange: the developing country gets jobs; the home country gets cheaper goods. The jobs created by Western firms in low-income countries average about eight times the per capita wages of the local area, providing a significant benefit to those who take such jobs in comparison to their other options.

The key to free trade's liberating role is that those who possess capital are able to bring it to workers who lack it, which in turn raises their productivity and enhances their earning power.

Seizing Opportunity

This explains why people seek jobs in Western-owned factories despite conditions that we in the West might find seriously unpleasant: They need to support their families, and these jobs offer a much better alternative than scraping a living off the land or collecting bottles and cans on the street or turning to prostitution. No one holds a gun to the heads of workers in Thailand or Indonesia when Nike or other folks come to town. They are smart enough to realize a better opportunity when they see it, and they take it. The result is the clearly observed correlation between per capita income and the degree of openness to international trade, all else equal. The increased wages of people working in Western-owned factories also permit greater demand for local products (such as food and clothing), enhancing employment opportunities and income, and causing another rise in the income-expenditure cycle elsewhere in the economy.

Meanwhile, back in the West, the cheaper imported goods enable Western consumers to have more income left over to spend on things they otherwise could not buy. If my shoes cost $15 less by being made overseas, I have $15 to spend on something else. That expenditure also creates employment opportunities in the West, normally for higher-paying capital-intensive manufacturing jobs or service-sector work. Consider how the cheapening of food costs thanks to mechanized agriculture has enabled the Western world to have considerable excess income to spend on nonagricultural goods and a variety of services. All those newly created jobs pay much better than the agricultural jobs displaced by mechanization. And some of those jobs may be created overseas, if the excess income is spent on other imports. Any time that consumers can purchase goods more cheaply because producers cut costs, there follows the creation of new, better-paying jobs elsewhere. In the last century the number of Americans employed in agriculture dropped from about 50 percent of the workforce to under 3 percent. That change was accompanied by a tremendous increase in per capita income (not to mention non-economic measures of well-being).

Free trade enables capital to come to those who need it most. In addition, the very profits that Western firms make in developing countries can be a long-run source of growth for those countries. Firms that operate there frequently "recycle" their profits back into investment in better technology and equipment in those countries. It is often cheaper for the firms to invest their own profits than to use formal banking institutions because the rate of indigenous savings is low and the financial institutional structure is often weak or nonexistent. Despite the claim of anti-globalization forces that free trade "puts profit before people," there is not a choice between "profits" and "people." Profits legitimately made in the market are a symbol of having created value and served people, and

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those same profits can be used in the future to make others better off. None of this assumes that Western firms are angelic, only self-interested. What the critics of globalization fail to recognize is that markets generate beneficial results as *unintended* consequences of the self-interested behavior of firms and individuals. Under a regime of free trade, self-interest is harmonized with the public interest, as the latter emerges as an unintended consequence of the former.

A further concern of many opponents of free trade and the globalization process is that they lead to the destruction of the environment. Two points need to be made with respect to that concern. The first is that the oft-cited "race to the bottom" is largely a myth. Environmental regulations are not one of the major factors that determine where firms locate (although very restrictive ones can push them up the list). Firms are much more concerned about secure property rights, a sound legal system, political stability, and access to communications and transportation than environmental regulations in and of themselves. The scenario where countries continually lower their standards to attract new firms is farfetched.

Free trade enables capital to come to those who need it most.

Second, and perhaps more important, is the overwhelming empirical evidence of what is called the Environmental Kuznets Curve. In country after country we see a U-shaped relationship between per capita income and environmental quality. As growth takes place, measures of environmental quality fall, but at about $5,000 per capita GDP this turns around, with almost all categories of environmental damage showing improvement at about $8,000. Although there will be short-run costs, in the long run the path to environmental protection is paved with economic growth. Free trade promotes that growth and thus will create the wealth necessary for clean technologies. To burden the developing world with Western-style environmental standards is to condemn its citizens to a longer stay in the poverty they wish to escape and would appear to replicate the paternalistic colonialism that anti-globalists decry. As former Mexican president Ernesto Zedillo put it: "A peculiar alliance has recently come into life. Forces from the extreme left, the extreme right, environmentalist groups, trade unions of developed countries and some self-appointed representatives of civil society are gathering around a common endeavor: to save the people of developing countries from—development."

Promotes Peace

One further benefit of free trade is that it promotes international peace. Countries that trade with one another create mutual interdependence, which raises the cost of armed conflict. If one country depends on another for cheap goods and services, what gain is there to a military invasion? Where interdependence is the nature of the relationship, fates are tied and war makes little sense. International conflict flows out of the sort of nationalism that results from restrictions on free trade. Just as democracies do not go to war with other democracies, so it is that countries with open trading relationships do not go to war. Peace and free trade have a long and storied history, and the very same thinkers who have argued for free trade, and have been excoriated for it by the antimilitarist left, did so because they believed it would promote international harmony and peace. The critics of free trade need to re-read both economic history and the history of ideas, and realize that their opposition to free trade is likely to *increase* international military activity, not reduce it.

What the critics of globalization have right, but not right enough, is the pernicious role of the IMF and World Bank. For those who support true free trade, these two institutions represent a step backward. The critics are correct, for example, in identifying many of the ways in which they, through their loans to various governments, have caused unnecessary environmental degradation through the inappropriate application of Western agricultural techniques over superior indigenous ones.

Just as important are the ways in which the strings attached to loans and aid from those institutions lead developing countries to adopt polices antithetical to

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long-run development. Many of the economic theories used by the IMF and World Bank are outdated and cause more harm than good. Moreover, they are overly focused on macroeconomic variables, such as investment rates or budget deficits, when the real problems facing many developing countries are microeconomic (such as overregulation of markets) or institutional (lack of well-defined property rights, political and legal instability, and more). Many anti-globalization protesters argue for reforming the IMF and World Bank to make them more responsive to local needs. However, they will always respond to those who have political power at the national level. Rather than reforming them, advocates of truly free trade should seek to close the doors of both and reduce the impoverishment of the developing world in the process.

Those who wish to improve well-being in the developing countries need to support the expansion of free trade. The recent agreements aimed at doing so (NAFTA and the proposed FTAA) are hardly ideal for this purpose. Although they clearly increase the flow of goods and services across borders, they also introduce a heavy dose of regulation into the process that undoes some of the benefits the trade would create. In addition, the documents are often not made public or are so difficult to read and understand that citizens have little idea of just how much special-interest influence has affected the final outcome.

That having been said, an imperfect free-trade agreement is better than none at all, and certainly better than one burdened with even more labor and environmental regulations that would prevent the developing world from taking advantage of the benefits of access to Western capital.

Finally, all sides involved in the globalization issue need to take a step back and recognize that a country's "external" policies (its policies concerning international trade and relations) are only half the equation. Free trade is necessary but not sufficient for development. A country's "internal" policies (regulation, monetary stability, and reliable political institutions) are at least as important for economic development. A country open to international trade but with highly restricted markets, high rates of inflation, weak legal and financial institutions, and political instability is unlikely to grow because it is not an attractive place even for those who can relocate there. An agenda for encouraging the spread of wealth to all humanity should support freedom not only across national borders but within them as well. Restrictions on free trade are no more noxious than misguided economic policies put in place by postcolonial leaders, who imported those ideas from economically ill-informed Western elites. The fight to reduce human poverty must take place on many fronts.

Many of the economic theories used by the IMF and World Bank are outdated and cause more harm than good.

Despite their attempts to monopolize it, the anti-globalists' views are not the only ones to lay a legitimate claim to the word "progressive." The more than 200-year-long attempt to open up the world to the free flow of goods, services, and people, and to make the wealth of the West available to the rest of the world, is one of the most progressive projects in human history. It has already resulted in previously unimaginable increases in wealth in those parts of the world most open to trade, and there is no reason to believe those benefits will not be extended to those who have yet to experience them.

Those who wish to slow down, stop, or politically control that process are the true reactionaries, standing atop the wave of human progress yelling "stop" simply because they cannot understand how an uncontrolled, spontaneously ordered process can possibly benefit everyone. Progress is not synonymous with intentional human control. Progress comes from good policies that let individuals use their local knowledge to their own benefit, and in doing so, unintentionally benefit others. The path toward development requires free trade. To restrict it is to condemn to prolonged poverty those who most need to escape it.

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The Great Outsourcing Scare of 2004

BY JUDE BLANCHETTE

Last year a protectionist wind filled the air. All the good jobs, Americans were told, were disappearing faster than one could say "New Delhi."

On opening his local newspaper, the typical American would find articles alerting, "As job exports rise, some economists rethink the mathematics of free trade." Or: "Thomson Trims 1,535 Jobs by Shifting Work to China." On his drive into work, he might turn on NPR and hear a sound bite by Senator John Kerry lambasting the "Benedict Arnold" CEOs who ship jobs abroad. That night after dinner, this American might turn on CNN to hear Lou Dobbs warn of "Exporting America."

In short, it appeared as if the whole country might soon find itself working at the nearest McDonald's. The new outsourcing, the use of white-collar services in foreign countries to cut costs, became one of the most debated issues on the news, in magazines, and on the op-ed pages of the largest newspapers. However, the Great Outsourcing Scare of 2004, like all protectionist scares, turned out to be one part sensationalism, one part economic ignorance.

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A much-publicized and well-reasoned *Foreign Affairs* article by Daniel W. Drezner essentially put the jobs issue to bed last May. Drezner showed that the numbers don't support the Dobbs argument: even using one of the most liberal estimates of job losses from outsourcing, "less than .2 percent of employed Americans" would be affected.[1] Drezner also notes that in regards to the outsourcing of the information-technology (IT) sector, many estimates use 2000 for comparison. Yet that was "an unusual year for the technology sector because Y2K fears and the height of the dot-com bubble had pushed employment to an artificially high level. When 1999 is used as the starting point, it becomes clear that offshore outsourcing has not caused a collapse in IT hiring."

Drezner concludes, "It is easy to praise economic globalization during the boom times; the challenge, however, is to defend it during the lean years of a business cycle. Offshore outsourcing is not the bogeyman that critics say it is. Their arguments, however, must be persistently refuted. Otherwise, the results will be disastrous: less growth, lower incomes—and fewer jobs for American workers."

While focusing exclusively on job losses (which the data show to be minor relative to the overall economy), detractors miss the dispersed benefits outsourcing will help bring via lower prices. According to the Reason Public Policy Institute, "For every dollar of spending on business services that moves offshore, U.S. companies save 58 cents."[2] Moreover, the McKinsey Global Institute (MGI) found that "Of the $1.45–$1.47 of value MGI estimates is created globally from every dollar . . . a domestic company chooses to divert abroad, the U.S. captures $1.12–$1.14 while the receiving country cap-

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tures on average 33 cents. In other words, the U.S. captures 78 percent of the total value."[3]

A further challenge to the protectionist case came in the form of "insourcing"—the opposite of outsourcing. Foreign firms, attracted by this country's (relatively) stable currency and political process, adherence to the rule of law, and protection of property rights, have hired Americans to replace workers in their home countries. There is, of course, little objection to this by Americans (including Dobbs). Observers have begun to report that jobs created by insourcing greatly outnumber those lost to outsourcing. According to the Organization for International Investment, 6.4 million jobs were insourced in 2001 alone. (Remember that the most alarming prediction is for three million jobs to be outsourced by 2015.) This is up from 5.1 million jobs in 1996.[4]

Two Reports

Yet perhaps the most damning evidence against the outsourcing scare comes from the federal government in two recent studies. Last June the Department of Labor reported that just 4,633 jobs were replaced by overseas labor during the first three months of 2004. This number represented 2 percent of the 239,361 layoffs for that same quarter.[5] Another study, released in September by the Government Accountability Office (GAO), concludes, "The Department of Labor's Mass Layoff Survey data show that layoffs attributable to overseas relocation represent a small fraction of overall total mass layoffs."[6] Put another way, the hysteria over outsourcing wasn't warranted. Even before these reports, economists who actually spent time examining the logic and numbers knew the protectionist rumblings were hot air.

The opponents of outsourcing presented it to the American public as a menace—if the government didn't protect us, virtually all white-collar jobs would be lost. It was a clear case of corporations ruthlessly pursuing ever-higher profits at all costs. Loyalty to the American worker and to the United States was abandoned for mammon and greed. Americans had gotten somewhat used to the idea of manufacturing jobs moving overseas, but the idea that office jobs could vanish too was frightening.

This simplistic outlook belies the multitude of factors that affect the outsourcing of jobs; cheap labor is but one. The high wages paid to Americans are determined, to a large extent, by productivity. American employers pay more because they receive more.[7] The United States has a highly skilled, proficient workforce that pays large dividends to employers. Furthermore, the relative stability of the American political and economic system offers benefits unmatched by most countries. If there is a threat to American workers, the U.S. government should get a large portion of the blame. Taxes, regulations, and mandated employee benefits, when taken together, drastically increase the cost of hiring Americans.[8]

Despite this preponderance of evidence, the issue of outsourcing still lingers, partly because of some workers' legitimate fears, but also because of a latent nationalism and xenophobia on the part of the protectionists. Outsourcing to Virginia is fine, but lo, give the job to an Asian and it's a national calamity. A man I recently spoke to told me that the only colors he saw were red, white, and blue. It is this unfortunate attitude that propels much of the protectionist nonsense today.

1. Daniel Drezner, "The Outsourcing Bogeyman," *Foreign Affairs*, May–June 2004, www.foreignaffairs.org/20040501faessay83301/daniel-w-drezner/the-outsourcing-bogeyman.html.

2. Adrian T. Moore, "More Good Than Harm: Can America Learn to Love Outsourcing?" *Privatization Watch*, vol. 28, no. 4, 2004, www.rppi.org/pw326.pdf.

3. McKinsey Global Institute, "Offshoring: Is It A Win-Win Game?" www.mckinsey.com/knowledge/mgi/rp/offshoring/perspective/index.asp.

4. Organization for International Investment, "The Facts about *Insourcing*," www.ofii.org/facts_figures/.

5. "U.S. Survey Finds Few Jobs Moving To Offshore Homes," *Wall Street Journal*, June 11, 2004.

6. See Government Accountability Office, "Report Abstract," September 22, 2004, www.gao.gov/docsearch/abstract.php?rptno=GAO-04-932.

7. See Bruce Bartlett, "Passage to India?" National Review Online, August 27, 2003, www.nationalreview.com/nrof_bartlett/bartlett082703.asp.

8. Joseph M. Johnson, "A Review and Synthesis of the Cost of Workplace Regulations," Mercatus Center, George Mason University, August 30, 2001, www.mercatus.org/pdf/materials/10.pdf.

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Detroit's Flirtation with Economic Suicide

BY LAWRENCE W. REED

Until recently, I had thought the city of Detroit had done everything in its power to drive people and businesses away. I was wrong. From deep down in its barrel of apparently endless crackpot schemes, the Detroit city council pulled out one more. And what a piece of work it was—proof beyond the most shadowy of doubts that getting elected to something doesn't mean you know up from down.

By a vote of 7–2 last September, the Council endorsed a paper titled "A Powernomics Economic Development Plan for Detroit's Under-served Majority Population." It spent a reported $112,000 for the document, written by a former low-level apparatchik in the Carter administration. It called for the creation of an "African Town" within the city, to be implemented by an overtly racist policy of dispensing city-financed loans and grants exclusively to black applicants.

Consider the backdrop. Perhaps no other metropolis in America has suffered more from destructive policies of government in the last half-century. Detroit's per capita tax burden is several times the average for the other municipalities in Michigan. The weight of its gargantuan bureaucracy and the extent of its legendary corruption are staggering. Its public schools are among the worst in the nation and, like the city itself, are teetering on the precipice of bankruptcy. Locally, city services have been likened to those of Third World backwaters. Racial tensions have gnawed at the city since the terrible riots of the 1960s.

Barely 40 years ago, Detroit boasted a population of more than two million. After decades of flight, scarcely 900,000 souls are left, many of them trapped in poverty and enveloped by some of the highest crime and welfare rates in the country.

The political establishment in Detroit is statist to the core. No failure of government is too big to prevent that establishment from throwing more public money at it. These remarks by economist Thomas Sowell, in a recent column about government in general, describe the powers that be in the Motor City quite well:

> It is fascinating to watch politicians come up with "solutions" to problems that are a direct result of their previous solutions. In many cases, the most efficient thing to do would be to repeal their previous solution and stop being so gung-ho for creating new solutions in the future. But, politically, that is the last thing they will do.

The weight of Detroit's gargantuan bureaucracy and the extent of its legendary corruption are staggering.

So facing a monumental, government-manufactured crisis, Detroit's politicians decided that turning the city's economy around required a new government program with race-based subsidies as its centerpiece. Non-black residents and immigrants need not apply. The *Detroit News* editorially blasted the plan, labeling it "a fraudulent and hateful document" and rightfully asserting that it "belongs on the shelf with Adolf Hitler's 'Mein Kampf.' " *News* columnist Thomas Bray reported on the initial reverberations of the city council's action:

> Hispanic-Americans, Greek-Americans and Arab-Americans turned out in force to protest, pointing out that [Detroit's] Mexicantown, Greektown and Chaldean businesses were built on

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sweat equity, not handouts from government. They also wondered why blacks, who constitute more than 80 percent of the population, should feel the need for something called African Town.

Shamefully divisive and destructively redistributionist, the "Powernomics" plan was the last thing beleaguered Detroit should have been embracing. Because of its racist nature it might have ultimately been tossed in the constitutional dumpster by the courts. Fortunately, a thunderous chorus of criticism from all over the state forced the city council within weeks to abandon the worst of the plan on a 5–4 vote. The premise that economic development in Detroit should be driven by government programs of some sort, however, still governs the thinking of Motor City officialdom.

"Economic Development"

The term "economic development" is one of the most overused and least understood concepts in public discussion today, even though the broad concept is generally regarded as something in which Americans have historically excelled. In recent decades, it has come to mean something other than the largely spontaneous, private-sector-driven phenomenon of this country's first century and a half. These days, the concept conjures up thoughts of an activist public sector directing resources, subsidizing specific firms, granting selective tax abatements, and making public "investments" in actual functioning companies. But studies by the boatload have shown that government does not create any net jobs and economic growth by robbing Peter to pay Paul or by supplanting the incentives of private entrepreneurs with its politically motivated schemes.

Detroit's "Powernomics" plan is just the latest and perhaps most virulent form of the failed government-focused approach to economic development. Indeed, expecting government to pick winners and losers instead of providing "a fair field and no favor" is an open door to abuse. Detroit's city council just happened to add a racial twist to that abuse.

> "And now that the legislators and do-gooders have so futilely inflicted so many systems upon society, may they finally end where they should have begun: May they reject all systems, and try liberty."
>
> — BASTIAT

The fact remains that economic development is what happens when government protects private property and minimizes its burdens on those who develop the economy by constructively pursuing their own self-interest—taking risks with their own funds and bringing their dreams to reality. If all that government does is keep the playing field safe from force and fraud, without discriminating on the basis of irrelevancies like race, entrepreneurs and the economy will flourish. Isn't that a lesson we all should have learned by now?

In at least one previous column for *The Freeman*, I cited an entreaty of the nineteenth-century French economist and statesman Frédéric Bastiat that cries out for application in this 21st-century instance: "And now that the legislators and do-gooders have so futilely inflicted so many systems upon society, may they finally end where they should have begun: May they reject all systems, and try liberty."

Detroit's political leaders, responsible as they are for one case of "planned chaos" after another, need not fork over the taxpayers' dollars for more statist schemes. They just need to get out of the way.

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Capitalism: Still on Trial

BY NORMAN BARRY

It was not enough to defeat communism and cause all socialists to rethink their anti-capitalist strategy. Still the private-property market system is under sustained attack from the left. But this time the opposition has a more profitable approach. The aim is no longer to socialize everything, but to subject capitalism to a prolonged ethical assault.

This approach is a bit more subtle and is immune from the empirical refutations that destroyed old-fashioned socialism. But the effect of the new critique could be as deadly as the familiar anti-capitalist nostrums. And it cannot be denied that capitalists themselves have been the main source of the new critique. Because of the business scandals of recent years, the opposition has been aided by the behavior of personnel in the business system. As I shall demonstrate, the problems of business today relate to some familiar quirks of the capitalist system, and naturally the critics have got it all wrong.

There are some easy targets. Unrestrained capitalism, it is said, produces unadulterated greed, and its problems can only be alleviated by yet more government regulation and more restraints on entrepreneurship, the creative driving force of business. And, of course, parallels are already being drawn between today's malfeasance and the infamous "decade of greed," the 1980s. But although both eras involve the same business problems, the mechanics of business change and behavior are rather different.

One of the greatest achievements of capitalism was the invention of the limited-liability, or joint-stock, company; its easily exchangeable shares and legal personality led to that flexibility which is the envy of markets that have not developed it. There are indeed two types (at least) of capitalism: the Anglo-American system, which emerged from the common law of contract, and the European system, which is the product of code law.

The Anglo-American theory of the corporation, despite legislative and judicial depredations, endures.[1] The managers of a corporation have a fiduciary (strict) duty to advance the interests of the owners, the stockholders. In the European model of capitalism, other groups, known as stakeholders, are thought to have a significant role in decision-making in the corporation. This is best exemplified in the German company, which has the two-board management system in which trade unions and others, often politicians and public figures, can be decisive. The statute that created the limited-liability company in 1870 decreed this. Though not eliminated, owners' rights are reduced. That is why takeovers are rare.

> The Anglo-American corporation, despite its many virtues, has been afflicted by the "agency" problem since its beginnings.

But the Anglo-American corporation, despite its many virtues, has been afflicted by one problem since its beginnings. It was first identified by Adam Smith and is known as the "agency" problem. The owners are the *principals*, the managers the *agents*.[2] The question is: how do we get the agents to observe their fiduciary

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duties and not run off with company assets, shirk on the job, and pursue their self-interest. They do have considerable discretion, especially in America under the "business judgment" rule, by which courts are prepared to accept almost anything done by managers as being in the interests of the company. Smith thought that the only viable form of business enterprise was the owner-managed firm.

If we compare the 1980s with the early years of the 21st century, we see the same problem but with widely different answers. It is a serious mistake of the critics of capitalism to bundle the two eras under the common name—greed. They are very different.

The 1980s saw a really significant shift in wealth and power from the managers to the owners. This was a response to the earlier accumulation of wealth and power by corporate executives. True, takeovers took place in the earlier period, but they were not designed to advance stockholder value. Rather they were to increase the wealth and power of the managers. This led to the creation of unwieldy conglomerates that held back American economic progress. Clever entrepreneurs like T. Boone Pickens and adroit financiers such as Michael Milken broke them up. Companies were captured by raiders, only this time to advance stockholder value. They were often taken private; management was slimmed down; and the companies were brought back to market to yield even more profits. The personnel involved in this were despised and their methods excoriated, yet the whole experience underlay the remarkable American prosperity at the end of the twentieth century. This was the result of the spontaneous evolution of capitalism.

Victims of Managerial Power

The very opposite happened at the beginning of this century. Stockholders had become the victims of a new era of managerial power. And, in comparison to the much-despised 1980s, which were characterized by rather high levels of probity, there was massive cheating by executives. They deceived the stockholders at every turn and rigged the stock market, and that much-prized value, transparency, which should be the main feature of good corporate governance, descended into a mystifying opaqueness. It was difficult for stockholders to know what was going on until it was too late.

Of course, the market eventually wreaked its revenge, and big companies all but collapsed under a sea of debt. The market does eventually punish wrongdoers, but a lot of people lose serious money on the way. A crucial feature here was the decline in effectiveness of the auditors and accountants. Supposedly independent of management, they are charged with the duty of providing stockholders with essential information about the company. But they were also engaged in lucrative consultancy work for the company. This obviously gave them an incentive not to reveal vital information. It would obviously have a deleterious effect on the price of the stock.

None of this had much to do with today's morality. Indeed, the people involved in scandals had high moral profiles. They gave money to charity (though that was often company money), practiced affirmative action in the workplace, and generally followed the dictates of conventional business ethics. But what the aberrant companies did in the last five years was to breach those conventions of good business practice that had grown up independently of statute and departments of moral philosophy at Ivy League universities.

Enron Collapses

Enron collapsed with massive debts in December 2001.[3] It was a hugely successful energy-trading company, though it began as a small gas firm. Its problems arose because it had embarked on highly ambitious schemes and engaged in complex derivative trading and various offshore ventures. It had managed to conceal its difficulties from the public and investors, and was still getting good reports from the press right up to its demise, although the credit-rating agencies always thought it a risky company.

The virtue of Anglo-American capitalism is that Enron-type disasters are avoided, or their worst effects mitigated, through constant stockholder pressure, either through "voice" (harassing management at annual general meetings) or "exit" (selling their stock to a raider). These are checking devices that have emerged spontaneously to solve the agency problem. But to be effective they require transparency on the part of companies.

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In the Enron case, stockholders were deceived about the true state of the company. This was done in a number of ways, the most important being the creation of Special Purpose Entities (SPEs). These are a kind of partnership within the firm, and they have the advantage, for someone anxious to conceal the truth, that their figures do not appear in the company's books. SPEs are not illegal. However, they are certainly imprudent, and in Enron's case their existence enabled the managers to evade the responsibility of telling the truth to investors.

Enron executives were distinguished by the fact that the bulk of their income came from stock options. This gave them an incentive to keep the price of the stock artificially high. Their auditors, the now-ruined Arthur Andersen company, helped them in this. The auditors were not defenders of the stockholders' assets, but were conspiring with the managers.

Neither federal nor state law was any help to the stockholders. The federal Williams Act of 1968 made it difficult for outside stockholders to organize tender offers and threaten management with surprise bids. Equally significant was the fact that all 50 states had passed their own anti-takeover laws in response to the boom of the '80s. This was largely at the behest of incumbent managers worried about their jobs. These laws were designed to protect the allegedly defenseless employees and investors. They did precisely the opposite, entrenching management instead.

Perhaps one of the most questionable acts of the Enron executives was to persuade workers to keep on buying stock in the company when the executives knew it was in desperate trouble. They were unloading shares at what was then a high price. One, CEO Kenneth Lay, has been charged with insider dealing (and other federal criminal offenses), a law of which I have written critically in the past: but this was not the real error in the case. It has been cogently suggested that Lay had good reasons for selling his Enron stock and that his sale was not merely a preemptive response to a future fall in its price.[4] But the appropriate remedy here for any wrongdoing should have been civil action. Enron executives were in breach of their fiduciary duties to the firm and its investors (especially the workers). However, the Justice Department has become adept at turning civil wrongs into serious criminal offenses. It is clear that that the action against Lay is more political than legal, and the long delay in bringing him to trial suggests this. Like other "white collar criminals" in the past, he has been so publicly vilified that a jury is unlikely to be impartial. Of course, the government wanted someone to blame. And the workers, through their representatives, were remiss in not demanding more information. No doubt they were misled into thinking that regulation would save them.

> The eighteenth-century Scottish philosopher David Hume was acutely aware of the dangers of a strident morality.

The WorldCom Case

The scandal at WorldCom, whose bankruptcy in 2002 matched that of Enron, revealed similar features of business malpractice. This was a small telecommunications company that became a world leader, largely through some spectacular takeovers. But it had suffered from bad investment decisions and some extraordinary extravagance by employees. Its founder and former chief executive, Bernard Ebbers, was said to have "borrowed" up to $408 million from the company. All the time information was withheld from the market so that investors could not make informed choices. An example was the company's representing as working profit $2 billion put aside for bad debts. These malfeasances had been going on since 1999, when Arthur Andersen was the auditor, and were only revealed by the replacement firm, KPMG.

Another great scandal that shocked the Anglo-American corporate world was the affair at Tyco International. This did not involve the complexities of corporate finance that Enron featured. It was more a case of straight theft from the firm. But it illustrates the familiar agency problem. Its chief executive, Dennis Kozlowski, and the chief financial accountant, Mark Schwartz, treated the company like a personal cash cow. Kozlowski is said to have spent $1 million of com-

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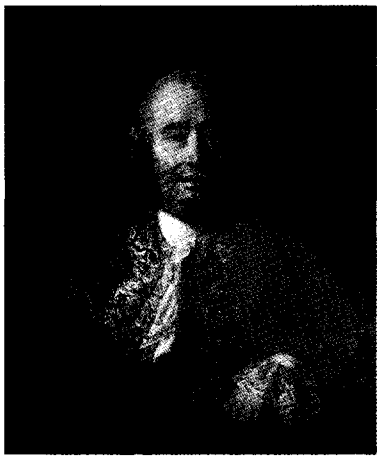
pany money on his wife's birthday celebration and, equally notoriously, $6,000 on a shower curtain for his home. The pair eventually faced a 32-count indictment, including charges of grand larceny. A mistrial was eventually ordered because of witness tampering, but the defense argument that the expenditure had board approval and that there was no criminal intent may prevail, bizarre though that seems.



David Hume

The lesson drawn by some business observers is that stockholders should be more active in the running of publicly quoted companies. But that is a little misleading, for traditionally the ultimate exercise of ownership rights, selling out to a raider, had been sufficient to keep management in line. In normal circumstances it is not in the rational self-interest for small owners to be involved in management. However, the aforementioned federal and state laws restricting takeovers have blunted that weapon; so a new form of stockholder activism might be required. And here there is clearly a role for big equity owners to take an interest in the company. They can see more clearly the effect of management on the value of their stock. Already this is happening. The huge public-sector pension organization, the California Public Employees Retirement System (CalPERS) is active in corporate governance and the practice is spreading throughout the Anglo-American capitalist world. After all, managers of pension funds have fiduciary duties to their members.

Limits of Morality

But in all these issues it is important to understand the nature and limits of morality. Moral philosophers have been far too anxious to stress supererogatory duties, that is, those that are worthy but not compelling, and have underplayed the basic rules by which we all live. The latter may not be glamorous, but successful business would be impossible without their observance.

The eighteenth-century Scottish philosopher David Hume was acutely aware of the dangers of a strident morality. He said that ethics has no basis in reason and was entirely a function of the passions. But this did not make him an *immoraliste*, for he believed that human experience shows how strict *conventions* (the basic and uncomplicated rules of morality) come to be adopted, especially for law, property, and economics.[5] By playing "repeat games" we overcome the absence of trust in human affairs so that self-interested utility-maximizers advance their own goals by cooperating. He was worried that morality had a tendency to become an "enthusiasm" detached from human experience. He would regard modern business ethics as one such enthusiasm. All the recent business scandals have involved clear breaches of fiduciary duties. We don't need a new moral philosophy to tell us that corporate theft and lying to stockholders are wrong. We only need to understand conventions.

European Capitalism

Just as the Europeans were preening themselves on their virtue in the light of American business scandals, they were suddenly shocked by the revelation that Parmalat, the huge Italian company, was facing bankruptcy with losses of 14.5 billion euros. This was in the Enron and WorldCom class for corporate chicanery.

Part of the original European claim for financial probity was that companies there were not primarily vehicles for the enrichment of greedy stockholders. European companies are "stakeholder driven" organizations in which a variety of groups essential to the business have a share in its governance. Owners (stockholders) are simply one of them. The influence of stockholders is further reduced because most investment capital is raised by bank loans rather than share issues. Since banks are also considerable equity holders, unlike in the United States or the United Kingdom, this gives them excessive influence in company policy. The banks are important figures on the supervisory boards of German companies, enabling them to put together coalitions of interests to resist the sanitizing effects of corporate raiders. Banks also act for

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minority stockholders. Since the restless search for stockholder value has not been a feature of German business, the significance of ownership is less than in the Anglo-American corporation.

However, as Italian experience reveals, the stakeholder system, so far from "democratizing" the corporation and making it responsive to demands of groups other than stockholders, has entrenched the management of a small group of self-interested insiders. True, Italian companies are quoted on the stock exchange, but they are effectively controlled by families. The Agnelli family's reluctance to cede control of Fiat, which has slid near bankruptcy, is the classic example. Italians have not developed the Anglo-American style of corporate governance because they have not developed a notion of trust (or reliance on Humean conventions). The anonymity of large-scale capital markets, as opposed to the intimacy of family ties, is alien to them. Italy is the heartland of "crony capitalism."

If crony capitalism is bad for business, as it unquestionably is, then the Parmalat case took it to new heights of venality.[6] Despite the absence of a love interest, a diva, and a dagger, it was worthy of a Verdi opera. Parmalat was originally a successful company specializing in dairy products. But gradually it lost interest in milk and cheese and acquired *worldwide* holdings in a variety of unrelated products.

Parmalat was able to carry on without restraint because of the absence of any checking mechanisms, least of all from stockholders, in the company. It was effectively controlled by one family, the Tanzi, and the dominant figure was Castilio Tanzi. He ruled the company like a medieval tyrant, and corporate governance was abysmal. Extensive bank loans were raised and companies bought at inflated prices. And unlike in American takeovers, the companies were not turned into viable business enterprises, but became the personal property of the Tanzi family. When disaster struck, Parmalat was an incomprehensible, impenetrable, and debt-ridden colossus with no discernible business strategy.

Despite their obvious differences, recent events in American and European business reveal a remarkable similarity: the shift in wealth and power to company executives.

Stakeholders Silent

And what did the legendary stakeholders do about all this? Precisely nothing, except blame one another. The crisis could have been averted if investors and bankers had taken action. As it turned out, they were silent and inactive and lost large amounts of money. There were culpable individuals involved, but the whole culture was rotten. In Italian business the importance of family control is so strong that the checking bodies are reluctant to stand up to them. That had not been too serious in the past, but the successful spread of globalization requires a notion of trust that extends beyond family members. And indeed, Parmalat's problems emerged when it became a globalized company.

Only in Germany are there signs of stockholder activism. Although the country had established a full-fledged market system under Ludwig Erhard in the 1950s, it had never adopted Anglo-American business techniques. Firms were always run by stakeholders, especially bankers, and stockholders had little influence. The apogee of German stakeholderism was reached in 2001 with the defeat of the hostile bid for Krupp by Thyssen. It was turned into a tame merger.

But the successful bid for Mannesmann by Vodafone in 2002 was a significant blow for Anglo-American capitalism.[7] The case had a curious aftermath. Mannesmann executives awarded themselves massive (American-style) "golden parachutes." This angered stockholders and caused great controversy in German business. The executives were eventually charged with criminal offences, and although they were acquitted, the whole saga marked a turning point in German business. There are other cases pending, and German stockholders are now demanding, vociferously, an Anglo-American-style of business with a new emphasis on stockholder value.

Despite their obvious differences, recent events in American and European business reveal a remarkable

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similarity: the shift in wealth and power to company executives. In America the investors were the losers, and in Europe other stakeholders suffered as well. In the 1980s the threat of a takeover kept agents (company executives) in line. Sadly, that has been seriously weakened through legislation, and in Europe it has always been moribund. But the natural, self-correcting mechanisms of the market are the only secure devices against fraud and the exploitation of the owners by managers.[8]

1. See Norman Barry, "The Theory of the Corporation," in *Ideas on Liberty*, March 2003, pp. 22–26, www.fee.org/~web/0303iolpdf/feat5.pdf

2. See Adolph A. Berle and Gardner C. Means, *The Modern Corporation and Private Property* (New York, Macmillan, 1932) for a critique of capitalism from this perspective.

3. See William A. Niskanen, *A Preliminary Perspective on the Major Policy Lessons from the Collapse of Enron*, Cato Institute, July 2002.

4. William L. Anderson and Candice E. Jackson, "Is Ken Lay a Criminal?" Ludwig von Mises Institute Daily Article, August 16, 2004, www.mises.org/fullstory.aspx?control=1589 Mises.org.

5. See Norman Barry, "Political Morality as Convention," *Social Philosophy and Policy*, vol. 21, 2004, pp. 266–92.

6. See *Financial Times*, April 13, 2004.

7. Norman Barry, "The Logic and Morality of Takeovers," *Ideas on Liberty*, July 2000, pp. 33–37.

8. The Sarbanes-Oxley Act of 2002 got some things right. For example, auditors must rotate every five years, and they cannot be consultants. But it also imposed heavy compliance costs on companies. However, companies could have done these things themselves, and were doing so, without the heavy regulatory burdens.

In brief

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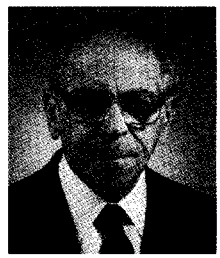

Benjamin Rush and "Medical Marijuana"

BY THOMAS SZASZ

Last November the U.S. Supreme Court considered the appeal in *Ashcroft v. Raich*, regarding approval for so-called medical marijuana, that is, for marijuana by prescription. Hearing the case, Justice Stephen Breyer stated: "Medicine by regulation is better than medicine by referendum."

This is a Hobson's choice: in either case, the individual is denied free access to the drug of his choice. Regrettably, some libertarians view the quest for medical marijuana as a cause deserving their support. In a vain effort to bolster their case, they mistakenly appeal to the authority of Benjamin Rush (1746–1813), the "father" of American psychiatry and a champion of the therapeutic state.

The following bogus statement, attributed to Rush, is quoted and requoted from one author and website to another: "Unless we put medical freedoms into the Constitution, the time will come when medicine will organize into an undercover dictatorship. . . . All such laws are un-American and despotic and have no place in a republic. . . . The Constitution of this republic should make special privilege for medical freedom as well as religious freedom." Rush never said any such thing, and anyone familiar with the history of psychiatry ought to recognize that the quotation is an obvious fabrication.

Rush crusaded for the medicalization of personal and social problems and their coercive control by means of "therapeutic" sanctions. He invented numerous diseases, among them the malady he named "derangement in the principle of faith or the believing faculty." He described it as follows: "[P]ersons who deny their belief in the utility of medicine, as practiced by regular bred [trained] physicians, believing implicitly in quacks; [and] persons who refuse to admit human testimony in favor of the truths of the Christian religion."

Like the advocates of medical marijuana today, Rush regarded his policies as humane and "mild." In fact, they were brutal: "Lying, as a vice, is said to be incurable. The same thing may be said of it as a disease. . . . Its only remedy is, bodily pain, inflicted by the rod, or confinement, or abstinence from food." For good measure, he added: "Terror acts powerfully upon the body, through the medium of the mind, and should be employed in the cure of madness." Rush went so far as to invent a new "therapeutic" device—actually, an instrument of terror and torture—which he presciently called the "tranquilizing chair."

> The temptation to believe what we want to believe rather than what is true is very powerful.

Not only did Rush oppose the kind of "medical freedoms" the bogus quote attributes to him, he also diagnosed "the excess of the passion for liberty" as a form of mental illness. Lamenting this passion, "inflamed by the successful issue of the [Revolutionary] war," he explained: "The extensive influence which these opinions had upon the understandings, passions, and morals of many of the citizens of the United States, constituted a form of insanity, which I shall take the liberty of distinguishing by the name of anarchia." Disappointed with his political efforts, he declared: "Were we to live our lives over again and engage in the same benevolent enterprise, our means should not be reasoning but bleeding, purging, low diet, and the tranquilizing chair."

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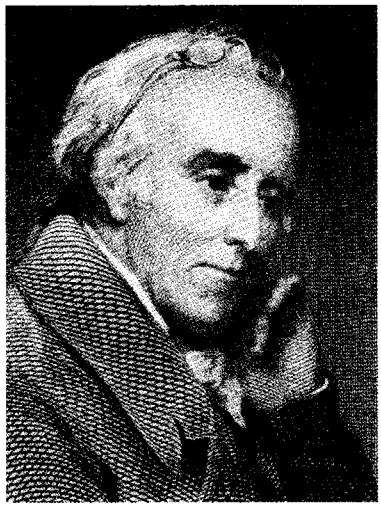
The temptation to believe what we want to believe rather than what is true is very powerful. This explains why many bogus quotes and false tales become virtually indestructible. Mark Twain wisely observed: "[The] maxim that 'Truth is mighty and will prevail' [is] the most majestic compound fracture of fact which any of woman born has yet achieved. For the history of our race, and each individual's experience, are sewn thick with evidences that a truth is not hard to kill, and that a lie well told is immortal. . . . How easy it is to make people believe a lie, and how hard it is to undo that work again!"



Benjamin Rush (1746–1813)

Examples abound. One of the most successful fabrications is H. L. Mencken's hilarious hoax about the history of the introduction of the bathtub into the United States. Written during the war-time Prohibition of 1917, the piece ostensibly memorialized the 75th anniversary of this fictitious event. Decades later, Mencken wrote: "The success of this idle hoax . . . vastly astonished me. . . . It had, of course, no truth in it whatsoever, and I more than once confessed publicly that it was only a jocosity. . . . " But it went on prospering and in fact is still prospering.

The bogus Rush quotation—without a scintilla of evidence to support it, and with a plethora of evidence against it—has become a "fact." A Google search of the World Wide Web reveals dozens of entries for it. But not a single author supplies a verifiable source for it.

Witches Were Really Mentally Ill?

It is important to remember that this is not the first time "humanitarian" hagiographers of psychiatry have repainted ugliness as beauty. Famed psychoanalyst and historian of psychiatry Gregory Zilboorg recast Johannes Weyer (1515–88) from medieval demonologist into a proto-psychiatrist who allegedly "recognized" that witches were "mentally ill": "[Weyer] leaves no doubt but that one conclusion is warranted: the witches are mentally sick people." With similar disregard for the truth, psychiatrists have created the legend of Philip Pinel (1745–1826) as a "reformer" who "struck the chains off the insane." In fact, what Pinel did was to medicalize the justification for incarcerating innocent persons in insane asylums.

Regarding the marijuana debate, Gilbert K. Chesterton, the celebrated Christian humanist-humorist-philosopher, said all there is to say on the subject: "The free man owns himself. He can damage himself with either eating or drinking; he can ruin himself with gambling. If he does he is certainly a damn fool, and he might possibly be a damned soul; but if he may not, he is not a free man any more than a dog."

Sadly, the individuals and organizations that make use of the bogus Rush quote have no interest in separating medicine and the state. If they had such an interest, they could use a genuine quote to support their cause. Mocking the would-be statist meddlers into our diets and drugs, Thomas Jefferson reminded Americans that "in France the emetic was once forbidden as a medicine, the potato as an article of food. . . . Was the government to prescribe to us our medicine and diet, our bodies would be in such keeping as our souls are now."

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Ludwig von Mises and The Vienna of His Time

PART I

BY RICHARD M. EBELING

Ludwig von Mises was a passionate advocate of reason who deeply believed in the value of human freedom. He also was a patriotic cosmopolitan; that is, in the years before he left Europe in 1940, Mises was deeply loyal to the Austria of his birth, while adhering to a philosophy and an outlook on life that was universalistic in its principles. In other words, Ludwig von Mises was an Austrian Jew.[1]

Ludwig von Mises

This may seem like a strange statement to anyone familiar with Mises's writings. In his memoirs, *Notes and Recollections*, he never once mentions the faith of his ancestors.[2] Nor does he speak in favor of Judaism—indeed, in his treatise on *Socialism*, he refers to Judaism as one of the stagnant and backward religions.[3] And only in *Omnipotent Government*, written during World War II from his exile in America, does he discuss and criticize anti-Semitism in Germany in particular and in Europe in general.[4] Yet, F. A. Hayek once commented that Mises considered himself to have been a victim of anti-Semitism in having never been awarded the academic position at the University of Vienna for which he considered himself rightfully qualified.[5]

Still, in many ways Mises's life from his birth in Lemberg in the old Austro-Hungarian Empire to his departure from the Austria of the interwar period reflects and parallels the triumphs and tragedies of the Jews of Austria. Mises was born September 29, 1881, in Austrian Poland, or Galicia, as it was called. In the last decades of the nineteenth century, 50 percent of the population of some parts of Galicia was Jewish, with the center of Jewish life and culture being in the province's capital, Mises's birthplace.[6]

The documents that Ludwig von Mises's great-grandfather, Mayer Rachmiel Mises, prepared as background for his ennoblement by the Austrian Emperor Franz Joseph in June 1881 (just a few months before Ludwig was born) record the history of the Mises family in Lemberg going back to the 1700s. Mayer's father, Fischel Mises, had been a wholesaler and real estate owner who had received permission to live and conduct business in the so-called "restricted district" reserved for non-Jews. At the age of 18, Mayer married a daughter of Hirsch Halberstamm, the leading Russian-German export trader in the Galician city of Brody.

Mayer took over the family business following his father's death and also served for 25 years as a commissioner in the commercial court of Lemberg. For a time he also was on the city council and served as a full member of the Lemberg Chamber of Commerce. He also was a cofounder of the Lemberg Savings Bank, and later was a member of the board of the Lemberg branch of the Austrian National Bank. In addition, he was a founder of a Jewish orphanage, a reform school, a secondary school, a charitable institution for infant orphans, and a library in the Jewish community. Some of these charities were begun with funds provided by Mayer for their endowment. Indeed, it was for his service to the Emperor as a leader of the

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Jewish community in Lemberg that Mayer Mises, great-grandfather of Ludwig von Mises, was ennobled.

Mayer's oldest son, Abraham Oscar Mises, ran the Vienna office of the family business until 1860, when he was appointed director of the Lemberg branch of the Creditanstalt bank. Abraham also was the director of the Galician Carl-Ludwig Railroad. It is perhaps because of Abraham's connection with this railroad that his own son, Arthur Edler Mises, took up civil engineering with a degree from the Zurich Polytechnic in Switzerland, and then worked for the Lemberg-Czernowitz Railroad Company. Arthur married Adele Landau, the granddaughter of Moses Kallir and the grandniece of Mayer Kallir, a prominent Jewish merchant family in Brody. Arthur and Adele had three sons, of whom Ludwig was the oldest. His brother, Richard, became an internationally renowned mathematician who later taught at Harvard University. The third child died at an early age.

Members of the Mises family also were devout practitioners of their Jewish faith. The vast majority of the Galician Jews were Hasidic, with all the religious customs and rituals that entailed.[7] As a small boy, Ludwig would have heard and spoken Yiddish, Polish, and German, and studied Hebrew in preparation for his bar mitzvah.

Ludwig's father, Arthur, like many of his generation, chose to leave Galicia and make his life and career in the secular and German cultural world of Vienna. But from the documents among Ludwig von Mises's "lost papers" in the Moscow archives,[8] it is clear that his mother maintained ties to her birthplace, contributing money to several charities in Brody, including a Jewish orphanage.[9] In Vienna in the 1890s, Arthur was an active member of the Israelite Community's Board, a focal point for Jewish cultural and political life in the Austrian capital.[10]

Denied Civil Liberties

Until the early and middle decades of the nineteenth century, Jews throughout many parts of Europe were denied civil liberties, often being severely restricted in their economic freedom and, especially in Eastern Europe, confined to certain geographical areas. In the 1820s Jews were still not permitted to live and work freely in Vienna; special permission from the Emperor was required.[11] Commercial and civil liberation of the Austrian Jews only occurred in the aftermath of the Revolution of 1848, most especially with the new constitution of 1867, which created the Austro-Hungarian Dual Monarchy following Austria's defeat in its 1866 war with Prussia.[12] The spirit and content of the 1867 constitution, which remained the fundamental law of the Empire until the collapse of Austria-Hungary in 1918, reflected the classical-liberal ideas of the time.[13] Every subject of the Emperor was secure in his life and private property; freedom of speech and the press was guaranteed; freedom of occupation and enterprise was permitted; all religious faiths were respected and allowed to be practiced; freedom of movement and residence within the Empire was a guaranteed right; and all national groups were declared to have equal status before the law.[14]

No group within the Austro-Hungarian Empire took as much advantage of the new liberal environment as the Jews. In the early decades of the nineteenth century a transformation had begun among the Jewish community in Galicia. Reformers arose arguing for a revision in the practices and customs of orthodox Jewry. Jews needed to enter the modern world and to secularize in terms of dress, manner, attitudes, and culture. The faith had to be stripped of its medieval characteristics and ritualism. Jews should immerse themselves in the German language and German culture. All things "German" were distinguished as representing freedom and progress.[15]

With the freedoms of the 1867 constitution, Austrian and especially Galician Jews began a cultural as well as a geographical migration. In 1869 Jews made up about 6 percent of the population of Vienna. By the 1890s, when the young Ludwig von Mises moved to Vienna with his family, Jews made up 12 percent of the city's population. In District I, the center of the city where the Mises family lived, Jews made up over 20 percent of the population. In the neighboring District II, the portion was over 30 percent.[16]

But in the late-nineteenth and early-twentieth centuries, there was a stark contrast between these two districts of the city. In District I the vast majority of the Jewish population had attempted to assimilate

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with their non-Jewish neighbors in dress, manners, and cultural outlook. On the other hand, in District II, bordering on the Danube, the Jewish residents were more likely to have retained their Hasidic practices and orthodox manners, including their traditional dress. It was the visible difference of these Jews, who often had more recently arrived from Galicia, which so revolted the young Adolf Hitler—who was shocked and wondered how people acting and appearing as they did could ever be considered "real Germans." They seemed such an obviously alien element in Hitler's eyes.[17]

The characteristic mark of most of the Jews who migrated to Vienna (and other large cities of the Empire, such as Budapest and Prague) was their desire and drive for assimilation; in many ways they tried to be more German than the German-Austrians. The Czechs, Hungarians, and Slavs, on the other hand, often were still focused on their traditional ways; the Hungarians in particular were suspicious of the Enlightenment, civil liberties, and equality—these threatened their dominance over the subject peoples in their portions of the Empire. To constrain the Hungarians, the Emperor increasingly put the Czechs, Poles, and Slavs under direct imperial administration on an equal legal footing with the German-Austrians.[18] For the Jews, Austrian imperial policy meant the end of official prejudice and legal restrictions, and the advent of civil rights and educational opportunities.[19] Their continuing and generally steadfast loyalty to the Habsburgs, however, led many of the other nationalities to be suspicious and anti-Semitic as the years went by. The Jews were viewed as apologists and blind supporters of the Habsburg Emperor, without whose indulgence and protection the Jews might have been kept within the ghetto walls.[20]

Civil liberties and practically unrestrained commercial and professional opportunity soon saw the Jews rise to prominence in a wide array of areas of Viennese life.[21] By the beginning of the twentieth century more than 50 percent of the lawyers and medical doctors in Vienna were Jewish. The leading liberal and socialist newspapers in the capital were either owned or edited by those of Jewish descent, including the *New Free Press*, the Viennese newspaper for which Mises often wrote in the 1920s and 1930s. The membership of the journalists' association in Vienna was more than 50 percent Jewish. At the University of Vienna in 1910, professors of Jewish descent constituted 37 percent of the law faculty, 51 percent of the medical faculty, and 21 percent of the philosophical faculty. At the time Mises attended the university in the first decade of the twentieth century, almost 21 percent of the student body was Jewish. The high proportion of Jews in literature, theatre, music and the arts was equally pronounced.[22]

German High-School System

The main avenue for social and professional advancement was education in the *gymnasium* system—the high-school system in the German-speaking world. The *gymnasium* education not only offered the path to higher education and a university degree for many Jews, but it also was an avenue for acculturation and assimilation into European and especially German culture. For example, Mises and his fellow student Hans Kelsen (who later became an internationally renowned philosopher of law and the author of the 1920 constitution of the Republic of Austria) attended the *Akademisches Gymnasium* in the center of Vienna. It was meant for students preparing for the university and professional careers. Here a wide liberal-arts education was acquired with mandatory courses in Latin, Greek, German language and literature, history, geography, mathematics, physics, and religion, with electives in either French or English—Mises selected French. At the core of the curriculum also was the study of the ancient Greek and Roman classics. Mises and other Jewish students at the *Akademisches Gymnasium*, as a part of their religion training, had courses in Hebrew.[23]

According to memoirs written by people who attended the *Akademisches Gymnasium* in the 1880s and 1890s, most of the students ridiculed the religion classes as "superstition." The Greek and Roman classics were considered literary avenues to the mainstream of modern European and Western culture. And while contemporary writings in history, social criticism, literature, and the sciences were not assigned, the students absorbed these works on their own as a way to integrate themselves into modern and "progressive" society.[24]

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In the 1890s, during Mises's time at the school, 44 percent of the student body was Jewish. But there were some *gymnasiums* at which Jewish admission was informally restricted. For example, the Maria Theresa Academy of Knights in Vienna was reserved for the children of the nobility and senior officials. Joseph Schumpeter attended it in the 1890s, but only because his stepfather was a lieutenant field-marshal. No matter what his academic qualification, Mises would have had virtually no chance of having been accepted there. There were clusters of these *gymnasiums* that were clearly closed to Jews, even if they were converts to Christianity, while other clusters represented the high schools where middle-class Jewish businessmen, professionals, and civil servants sent their children.[25]

But for all their assimilationist strivings—their conscious attempts to be German-Austrians in thought, philosophy, outlook, and manner—they remained distinct and separate. Not only was this because they belonged to schools, professions, and occupations in which they as Jews were concentrated, but because non-Jewish German-Austrians viewed them as separate and distinct. However eloquent and perfect the Jews' German in literature and the spoken word, no matter how valuable their contributions to Viennese society and culture, most non-Jewish Viennese considered these to be Jewish contributions to and influences on German-Austrian cultural life.

Name, family history, gossip, and mannerisms made it clear to most people who was Jewish and who was not. The wide and pronounced success of so many Viennese Jews made non-Jews conscious of their preponderance and presence in many visible walks of life. And it served as the breeding ground for anti-Semitism.[26]

In the Habsburg domains, part of this anti-Semitism was fed by conservative and reactionary forces in society that often resented the Emperor's diminishment or abolition of the privileges, favors, and status of the Catholic Church and the traditional landed aristocracy. The high proportion of Austrian Jews involved in liberal or socialist politics made them targets of the conservatives who said they were carriers of modernity, with its presumption of civil equality, unrestrained market competition, and a secularization that was said to be anti-Christian and therefore immoral and decadent. Preservation and restoration of traditional and Christian society, it was claimed, required opposition to and elimination of the Jewish influence on society. Jews were the rootless "peddlers" who undermined traditional occupations and ways of earning a living, as well as the established social order of things. They pursued profit. Honor, custom, and faith were willingly traded away by them for a few pieces of gold, it was said. Craft associations became leading voices of anti-Semitism, especially when economic hard times required small craftsmen and businessmen to go hat in hand to Jewish bankers for the borrowed sums to tide them over these times of economic trouble.[27]

Anti-Jewish Sentiment

German nationalism also was a vehicle for growing anti-Jewish sentiment. The paradox here is that in the 1860s and 1870s a sizable number of Jewish intellectuals were founders and leaders in the Austrian and German nationalist movements. German culture and society were viewed as representing the universal values of reason, science, justice, and openness in both thought and deed. German culture and political predominance within the Austro-Hungarian Empire restrained the backward-looking forces of darkness, that is, the Hungarian, Czech, and Slavic threats. At the same time, German influence in Central Europe offered rays of enlightenment in Eastern Europe.

Mises estimated that before World War II, Jews made up 50 percent of the business community in Central Europe and 90 percent of the business community in Eastern Europe.[28] Indeed, in *Omnipotent Government* he asserted that in Eastern Europe "modern civilization was predominantly an achievement of Jews."[29] What the Jews in these parts of Europe introduced and represented, at least in their own view, was the enlightened German mind, with its culture and institutions. But to the nationalities being introduced to and "threatened" by this German cultural influence, it was perceived as Jewish as much as German—a dominating, imperial, and "foreign" culture.

At the same time, in both Germany and German-Austria, many of the Christian German nationalists viewed the Jews in the forefront of the Pan-German

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nationalist movements as interlopers. As a consequence, in the second half of the nineteenth century, rationalizations emerged to justify the rejection of Jewish participation in the cause of German nationalism and culture. It was said that only Christians and the Christian faith were consistent with true German life and culture. But when a significant number of German and Austrian Jews converted to Christianity, it still was found not to be enough. Now it was claimed that to be a true German it was not sufficient to be a convert to Christianity. "Germanness" was a culture, an attitude toward life and a certain sense of belonging to the *Volk* community.

As a growing number of Jews immersed themselves in all things German—language, philosophy, literature, dress, and manner—it was found, again, not to be enough. Really to be a German was to share a common ancestry, a heritage of a common blood lineage.[30] This was one barrier the German and Austrian Jews could not overcome. In the emergence of racial anti-Semitism in the 1880s and 1890s were the seeds of the "final solution."

In Vienna the spirit of anti-Semitism was represented by Karl Lueger, who was mayor of the capital city in the first decade of the twentieth century and a leader of the Christian Social Party. He insisted that only "fat Jews" could weather the storm of capitalist competition. Anti-Semitism, Lueger said, "is not an explosion of brutality, but the cry of oppressed Christian people for help from church and state."[31] He blended anti-Semitism with social-left reforms, which included civil-service and municipal-government restrictions on Jewish access to city jobs or contracts. On the other hand, when Lueger was challenged on why he had Jewish friends and political associates, he replied, "I decide who is a Jew."[32]

But in spite of the presence and growth of anti-Semitic attitudes in the late-nineteenth and early-twentieth centuries in Austria in general and Vienna in particular, Mises's lack of attention to his own Jewish family background or any hint of the impact of anti-Semitism around him—there were anti-Jewish student riots at the University of Vienna during the years when he was a student there around the turn of the century—was in fact not uncommon. One can read Stefan Zweig's fascinating account of everyday life in the Vienna of this time and have the distinct impression that anti-Semitic attitudes and municipal-government policy were virtually nonexistent.[33]

Invisible Walls

Yet the circles in which people moved in Viennese society both before and after World War I existed with many invisible walls. Traditional or orthodox Jews lived and worked within a world of their own in the city.[34] Secular and assimilated Jews, like Ludwig von Mises and Hans Kelsen, moved in circles of both Jews and non-Jews; but even the nonreligious and German-acculturated Jews clustered together. A review of the list of participants in Mises's famous private seminar in Vienna, for example, shows a high proportion of Jews.[35] And even after Mises had moved to Geneva, Switzerland, in 1934, his agenda books for this time show that many of his social engagements were with other Jews residing in that country.

The end of the nineteenth and the beginning of the twentieth century saw the eclipse of liberalism in Austria and the rise of socialism in its place, centered in the political ascendancy of the Social Democratic Party. A sizable number of Jews were prominent in the Austrian socialist movement; they were anti-capitalist and viewed the entrepreneurial segment of the society as exploiters and economic oppressors. The capitalist class would be swept away in the transformation to socialism, including the Jewish capitalists in the "ruling class." Most of the Jews in the socialist movement were not only secular and considered themselves harbingers of the worker's world to come; they were also contemptuously opposed to cultural and religious Judaism as well.[36]

These three political movements in Austria and Vienna when Mises was a young man—conservatism, German nationalism, and radical socialism—were, each for its own reasons, enemies of liberal society, opponents of free-market capitalism, and therefore threats to the ideas and occupations of those middle-class, or "bourgeois," walks of life heavily populated by the Jews of Austria and Vienna.

The history of Austrian Jewry during this time is a story of triumph and tragedy. The winds of

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nineteenth-century liberalism freed the Austrian Jewish community, both internally and externally. Internally, the liberal idea pried open orthodox Jewish society in places such as Austrian Galicia. It heralded reason over ritual; greater individualism over religious collectivism; open-minded modernity over the strictures of traditionalism. Externally, it freed the Jewish community from legal and political restrictions. The rights of freedom of trade, occupation, and profession opened wide many opportunities for social improvement, economic betterment, and political acceptance.[37]

Within two generations this transformed Austrian Jewish society. And within that same span of time it saw the rise of many Jews to social and economic prominence, with greater political tolerance than ever known before. If these two liberating forces had not been at work, there would not have been Ludwig von Mises—the economist, the political and social philosopher, and the notable public figure in the Austria between the two world wars.[38]

At the same time these two liberating forces set the stage for the tragedy of the German and Austrian Jews. Their very successes in the arts and the sciences, in academia, and in commerce fostered the animosity and resentment of those less successful in the arenas of intellectual, cultural, and commercial competition. It set loose the emotion of envy, the terror of failure, and the psychological search for excuses and scapegoats. It ended at the gates to the Nazi death camps.[39]

1. On the general meaning of liberalism among many of the Austrian Jews in the late nineteenth and early twentieth centuries as representing a belief in the importance and role of reason in human affairs, a universal or cosmopolitan philosophy of individual rights and equality before the law, an advocacy of voluntary association outside of state regulation and control, and a loyalty to a multinational political authority (the Habsburg emperor) as a defender and protector of these ideas, see Pieter M. Judson, "Rethinking the Liberal Legacy" and Malachi Haim Hacohen, "Popper's Cosmopolitanism" in Steven Beller, ed., *Rethinking Vienna, 1900* (New York: Berghahn Books, 2001), pp. 57–79 and 171–94; and Marsha L. Rozenblit, *Reconstructing a National Identity: The Jews of Habsburg Austria During World War I* (Oxford University Press, 2001), pp. 14–38.

2. Ludwig von Mises, *Notes and Recollections* [1940] (South Holland, Ill.: Libertarian Press, 1978); these memoirs were written in the autumn of 1940 shortly after Mises and his wife, Margit, had arrived in the United States from war-torn Europe.

3. Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* [1922; revised ed., 1932] (Indianapolis: Liberty Classics, 1981), p. 370: "Today the Islamic and Jewish religions are dead. They offer their adherents nothing more than ritual. They know how to prescribe prayers and fasts, certain foods, circumcision and the rest; but that is all. They offer nothing to the mind. Completely despiritualized, all they teach and preach are legal forms and external rule. They lock their follower into a cage of traditional usages, in which he is often hardly able to breathe; but for his inner soul they have no message. They suppress the soul, instead of elevating and saving it. . . . Today the religion of the Jews is just as it was when the Talmud was drawn up. The religion of Islam has not changed since the days of the Arab conquests. . . . But it is otherwise in the living [Christian] Church of the West. Here, where faith is not yet extinct, where it is not merely external form that conceals nothing but the priest's meaningless ritual, where, in a word, it grips the whole man, there is a continuous striving after a social ethic. Again and again do its members go back to the Gospels to renew their life in the Lord and His message."

4. Ludwig von Mises, *Omnipotent Government: The Rise of the Total State and Total War* (New Haven, Conn.: Yale University Press, 1944), pp. 169–92, a chapter on "Anti-Semitism and Racism."

5. F. A. Hayek, "Ludwig von Mises (1881–1973)" in Peter G. Klein, ed., *The Collected Works of F. A. Hayek, Vol. 4: The Fortunes of Liberalism: Essays on Austrian Economics and the Ideal of Freedom* (Chicago: University of Chicago Press, 1992), p. 128.

6. See William O. McCagg, Jr., *A History of Habsburg Jews, 1670–1918* (Bloomington, Ind.: Indiana University Press, 1989), pp. 105–122 and 181–200.

7. But it is clear that Mayer Mises's family were active in the Jewish reform movement in Galicia, including the assimilation into German culture through the learning and use of the German language, as well as a desire to politically and socially cooperate with the ethnic Poles in the neighboring Galician community. See McCagg, *A History of Habsburg Jews*, pp. 114–17.

8. See Richard M. Ebeling, "Mission to Moscow: The Mystery of the 'Lost Papers' of Ludwig von Mises," *Notes from FEE* (July 2004).

9. In the late 1920s, Adele Mises dictated her memoirs about her life in Galicia and Vienna. She refers to the emphasis on charitable work within her family in Brody, saying that "the memories of my youth all relate to charitable activities. They occupied our parents' lives so completely that we children naturally became involved with them as well from an early age." And she recalled "my aunt Halberstamm angrily remarking to her sister (my dear mother-in-law): 'You heartless Lembergers' (there was always an antagonism between Brody and Lemberg) 'you sit behind closed doors and care about nothing at all!' Actually, my mother-in-law also came from Brody and was compassionate and charitable. The accusation was most unjust. Of course, in Lemberg people had bells and locked their front doors, but the back door to the kitchen remained open just as in Brody" to the poor and orphaned who needed charitable assistance.

10. Robert S. Wistrich, *The Jews of Vienna in the Age of Franz Joseph* (New York: Oxford University Press, 1990), p. 165.

11. On the history of the Jews in the Austro-Hungarian Empire, see Wistrich, *The Jews of Vienna in the Age of Franz Joseph*; McCagg,

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A History of Habsburg Jews, 1670–1918; Steven Beller, *Vienna and the Jews, 1867–1938: A Cultural History* (Cambridge, Mass.: Cambridge University Press, 1989).; George E. Berkley, *Vienna and Its Jews: The Tragedy of Success, 1880–1980s* (Lanham, Md.: Madison Books, 1988); and Max Grunwald, *History of the Jews in Vienna* (Philadelphia: Jewish Publication Society of America, 1936).

12. Full legal and economic rights were extended to Jews in Germany only in 1871, following the Franco-Prussian War and the unification of the German Empire under Prussian leadership.

13. In 1867, the Lower Austrian Chamber of Commerce located in Vienna (where Ludwig von Mises was to work as an economic analyst from 1909 until he left Austria in 1934) declared that "The state has fulfilled its task if it removes all obstacles to the free, orderly activity of its citizens. Everything else is achieved by the considerateness and benevolence of the factory owners and above all by the personal efforts and thriftiness of the workers." See Robin Okey, *The Habsburg Monarchy: From Enlightenment to Eclipse* (New York: St. Martin's Press, 2001), p. 206.

14. The Fundamental Law Concerning the General Rights of Citizens from the Austrian Constitution of 1867 may be found at: www.h-net.org/~habsweb/sourcetexts.auscon.htm.

15. This transformation of the Jewish communities in Central and Eastern Europe, especially in the German-speaking lands, is usually associated with the influence of Moses Mendelssohn beginning in the middle of the eighteenth century. See Marvin Lowenthal, *The Jews of Germany: A Story of 16 Centuries* (Philadelphia: The Jewish Publication Society of America, 1938), pp. 197–216; Ruth Gay, *The Jews of Germany: A Historical Portrait* (New Haven, Conn.: Yale University Press, 1992), pp. 98–117; Nachum T. Gidal, *Jews in Germany: From Roman Times to the Weimar Republic* (Köln, Germany: Konemann Verlagsgesellschaft mbH, 1998), pp. 118–23; Amos Elon, *The Pity of It All: A History of the Jews in Germany, 1743-1933* (New York: Metropolitan Books, 2002), pp. 1–64.

16. On the demographics of the Jewish community in Vienna, see Marsha L. Rozenblit, *The Jews of Vienna, 1867-1914: Assimilation and Identity* (Albany, N.Y.: State University of New York Press, 1983).

17. Adolf Hitler, *Mein Kampf* [1925] (Boston: Houghton Mifflin, 1943), p. 56: "Once as I was walking through the Inner City [of Vienna before the First World War] I suddenly encountered an apparition in a black caftan and black hair locks. Is this a Jew? was my first thought. For, to be sure, they had not looked like that in Linz. I observed the man furtively and cautiously, but the longer I stared at this foreign face, scrutinizing feature after feature, the more the first question assumed a new form: Is this a German?"

18. On the "nationalities problem" and its respective goals and perspectives, see Robert A. Kann, *The Multinational Empire: Nationalism and National Reform in the Habsburg Monarchy, 1848–1918*, 2 Vols. (New York: Columbia University Press, 1964); and Oscar Jaszi, *The Dissolution of the Habsburg Monarchy* (Chicago: University of Chicago Press, 1928).

19. Habsburg enlightenment was more advanced in many ways over that of the German government. For example, before the First World War it was virtually impossible for a Jew to be commissioned as an officer in the German Army, no matter his qualifications and merit. On the other hand, Jews were accepted as officers in the Austrian Army with no similar prejudice, which enabled Ludwig von Mises to be commissioned as a reserve officer in the Austrian Army as a young man, and serve with distinction in the First World War on the Russian front. See Wistrich, *The Jews of Vienna in the Age of Franz Joseph*, pp. 174–75: "In striking contrast to the Prussian regiments, there was no deliberate exclusion of Jewish officers and anti-Semitism was not officially tolerated. Indeed, anti-Semitism appears to have been notably weaker in the army than in many other sectors of Austrian society in spite of persistent nationalist agitation and the fact that most officers were Roman Catholic Germans. . . . In this supranational institution par excellence which was loyal to the Emperor and the dynasty alone, Jews were by and large treated on equal terms with other ethnic and religious groups. The army could simply not tolerate open racial or religious discrimination which would only undermine morale and patriotic motivation."

20. On the perception of the Jews before the First World War by the various nationalities of the Austro-Hungarian Empire, including the Austrian-Germans, see Henry W. Steed, *The Hapsburg Monarchy* [1913] (New York: Howard Fertig, 1969), pp. 145–94.

21. See Jerry Z. Muller, *The Mind and the Market: Capitalism in Modern European Thought* (New York: Alfred A. Knopf, 2002), pp. 350–52.

22. On the occupational demographics, see Rozenblit, *The Jews of Vienna, 1867–1914*, pp. 47–70; Beller, *Vienna and the Jews, 1867–1938*, pp. 165–87.

23. On the Vienna *gymnasiums*, and Jewish assimilation and social and economic advancement, see Rozenblit, *The Jews of Vienna, 1867–1914*, pp. 99–126; Beller, *Vienna and the Jews, 1867–1938*, pp. 49–70.

24. See Arthur Schnitzler, *My Youth in Vienna* (New York: Holt, Rinehart and Winston, 1970), for a rich memoir on the *Akademisches Gymnasium* in Vienna a few years before Mises attended as a student. Also, see the fascinating account of Viennese *gymnasium* life during this time in, Stefan Zweig, *The World of Yesterday* (New York: Viking Press, 1943), pp. 28–66.

25. On the Maria Theresa Academy of Knights in Vienna during the time when Schumpeter attended, see Robert Loring Allen, *Opening Doors: The Life and Work of Joseph Schumpeter*, Vol. 1 (Brunswick, N.J.: Transaction Books, 1991), pp. 18–22; and, Richard Swedberg, *Schumpeter: A Biography* (Princeton, N.J.: Princeton University Press, 1991), pp. 10–12.

26. On the nature and evolution of anti-Semitism in Germany and Austria, see Peter G. J. Pulzer, *The Rise of Political Anti-Semitism in Germany and Austria* (New York: John Wiley, 1964); and Bruce F. Pauley, *From Prejudice to Persecution: A History of Austrian Anti-Semitism* (Chapel Hill: University of North Carolina Press, 1992).

27. That the real target behind much of the anti-Semitism in Germany and Austria was economic liberalism has been suggested by Frederick Hertz, *Nationality in History and Politics* (New York: Oxford University Press, 1944), p. 403: "It was rightly felt by many that the real object of [anti-Semitic attacks such as those by the Germany historian Heinrich von Treitschke, who coined the

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phrase, 'The Jews are our misfortune'] was not the Jews, but liberalism, and that the Jews were only used as a means for working up public opinion against its fundamental principles." See also F.A. Hayek, *The Road to Serfdom* (London: George Routledge and Sons, 1944), p. 104: "In Germany and Austria the Jew had come to be regarded as the representative of capitalism because a traditional dislike of large classes of the population for commercial pursuits had left these more readily accessible to a group that was practically excluded from the more highly esteemed occupations. It is the old story of the alien race being admitted only to the less respected trades, and then being hated still more for practicing them. The fact that German anti-semitism and anti-capitalism spring from the same root is of great importance for the understanding of what has happened there, but this is rarely grasped by foreign observers."

28. Ludwig von Mises, "Postwar Economic Reconstruction of Europe" [1940] in Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, Vol. 3: *The Political Economy of International Reform and Reconstruction* (Indianapolis: Liberty Fund, 2000), p. 27.

29. Mises, *Omnipotent Government: The Rise of the Total State and Total War*, p. 185.

30. This attitude was expressed, as one example, during the 1930s by the ardent National Socialist Adolf Bertels, who said about Heinrich Heine, possibly the greatest German writer of the nineteenth century, that "however well he handles the German language and German poetical forms, however much he knows the German way of life, it is impossible for a Jew to be a German." Quoted in Alistair Hamilton, *The Appeal of Fascism: A Study of Intellectuals and Fascism, 1919–1945* (London: Anthony Blond, 1971), p. 109.

31. Quoted in, J. Sydney Jones, *Hitler in Vienna, 1907–1913: Clues to the Future* (New York: Cooper Square Press, 2002), p. 155.

32. Ibid., p. 157; also, Berkley, *Vienna and Its Jews*, pp. 103–111; on the history of the Christian Socialist movement and Lueger's role and participation in it, see John W. Boyer, *Political Radicalism in Late Imperial Vienna: Origins of the Christian Social Movement, 1848–1897* (Chicago: University of Chicago Press, 1981), and John W. Boyer, *Culture and Political Crisis in Vienna: Christian Socialism in Power*, 1897–1918 (Chicago: University of Chicago Press, 1995).

33. Stefan Zweig, *The World of Yesterday*. Zweig was born the same year as Mises, 1881, and was forced to leave Vienna with the rise of Nazi power in Austria. He went into exile in Brazil, where he committed suicide in 1942.

34. Harriet Pass Freidenreich, *Jewish Politics in Vienna, 1918–1938* (Bloomington, Ind.: Indiana University Press, 1991), p. 138.

35. Mises, *Notes and Recollections*, p. 100.

36. See Robert S. Wistrich, *Socialism and the Jews* (East Brunswick, N.J.: Associated University Presses, 1982).

37. And many of the Jews in Germany and Austria understood that connection between economic liberalism and individual opportunity that had enabled so many in the Jewish community to prosper in spite of anti-Semitic sentiments. Thus, for example, in 1897, Emil Lehmann, head of the Dresden Jewish community argued against the Social Democrats, "In the Mosaic teaching the ideals of justice and equality before the law find their substantiation just as envy and hatred—which the Social Democracy share with the anti-Semites—receive the sharpest condemnation. Thou shalt not covet! Other demands contrary to civilization such as the abolition of the family, State education of children, etc. etc, which are desired by the Social Democrats, are firmly rejected in the Ten Commandments." Quoted in Wistrich, *Socialism and the Jews*, p. 69.

38. On Mises's role and prominence in the Austria of the interwar period, see Richard M. Ebeling, "The Economist as the Historian of Decline: Ludwig von Mises and Austria between the Two World Wars," in Richard M. Ebeling, ed., *Globalization: Will Freedom or World Government Dominate the International Marketplace?* (Hillsdale, Mich.: Hillsdale College Press, 2002), pp. 1–68.

39. That the loss due to anti-Semitism did not only fall upon the Jews who were robbed of their property, exiled, imprisoned, or murdered in the concentration and death camps was pointed out by Hugo Bettauer in his fictional account *The City Without Jews: A Novel of Our Time* (New York: Bloch Publishing, 1926). Originally published in German in Vienna in 1923, it imagines a complete expelling of the Jews from Vienna at some future point in the city's history. And with the Jews goes much of the city's cultural, social, and economic achievement and potential. Indeed, the city decays in cultural and economic poverty without the contribution of Vienna's former Jewish citizens.

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Unjust Compensation

BY STEVEN GREENHUT

When discussing eminent-domain horror stories with government officials and other defenders of the practice, one will often hear a refrain of this sort: "None of this is any big deal, really, because the victims of eminent domain must be made financially whole, under the law." But, just as the Constitution's clear requirement that government only take property for "public" use has been twisted so that a Costco is a public use, so too has its demand that governments pay "just compensation" been distorted so that woefully low offers are considered "just."

Governments have found all sorts of ways to deny appropriate financial payments to home and business owners, and even when a fair-market value eventually is paid, it's questionable whether anything can pay for the torment and tumult—often including months or years of court battles and business losses—an owner has been put through. Keep in mind that the courts define fair-market value as less than what would be paid in a voluntary transaction, so in any eminent-domain proceeding the victim, by law, will not be made whole.

The Constitution requires the payment of just compensation, and the states and federal government have laws designed to flesh out exactly what that means. But the process rarely works out fairly for sellers, given some flaws in the process. First, *there is no just compensation when an owner is forced to sell, no matter the price offered.* A truly "just" price is the price freely accepted by willing buyers and willing sellers. Anytime government negotiates for a property and threatens to take it by force if the seller doesn't agree to the terms, the price is neither a true market transaction nor fair to the seller.

"You have to pay dearly to be treated fairly," is how Steven Strooh, vice president of Des Moines Blue Print Co. in Des Moines, Iowa, puts it after having had the facility of the business he works for taken by the city in 2000 to make way for a new downtown office building.

The story of Des Moines Blue Print is worth reviewing in detail because it is, from the property owner's standpoint, a relative success story. The business managed to find a decent new location, get a decent valuation, and keep most of its clientele. But as good as things went, the process was still a nightmare for the owner—a process that required intense time and financial commitments to assure he didn't get abused. Even so, the owner still lost tens of thousands of dollars.

It was March 2000. Strooh and company owner Leonard Ainsworth were sitting in the office going over the day's work. One of the company's employees knocked on the door and asked, "Have you seen the newspaper today? There's something about a new building, and it looks like it will go right where we are."

"Lo and behold," said Strooh, "the map in the *Des Moines Register* shows three city blocks right over our premises. This wasn't a proposal, either. The city council had voted to give Nationwide Insurance our property and the property of our neighbors. No one had told us about it. The article said the city would

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acquire the land for the company. We shook our heads in disbelief. We kept looking at the map and checking it, and checking the street signs. It was a surreal feeling. There was no way, as property taxpayers, we could comprehend that they would do this without notifying owners. If we were tenants it might make sense, but we were the owners. . . . Len and I couldn't believe it. We were incredulous."

One of the problems with eminent domain is that city officials have no comprehension—or they don't care—about what is involved in building a business from scratch. They look at a business and figure it can easily be moved. No big deal. The appraiser comes in and makes an offer, and the company moves. From the outside, Des Moines Blue Print, like many of the small businesses around it on the western edge of downtown Des Moines, looked modest.

A Life's Work

But Des Moines Blue Print wasn't just a business. It was also the life's work of its owner and employees. It was the result of years of dreams and investments, a successful business that had gone through good years and bad, a small manufacturing plant with specialized needs that could not be replaced with the snap of a bureaucrat's fingers.

The business had started at its location in the 1970s. Ainsworth bought it in the early 1980s, brought in new equipment, expanding the operation to the second floor, and began enlarging the company. It mainly provided blueprints, black-and-white photographic reproduction, and signs for commercial clients. In 1994 Strooh moved from his native South Africa to Des Moines to take a job at the company, with the goal of building a new color-printing operation. With computerization and digital equipment becoming the state of the art, the company's traditional black-and-white-photography work was declining, so Ainsworth and Strooh decided to take a chance on an emerging market.

With so much overlap between the black-and-white business and the new color business, Ainsworth decided he needed to buy the building next door. To acquire it, he had to pay a premium—about $200,000 more than it would fetch on an appraisal. Yet when eminent domain rears its ugly head, city appraisers refuse to compensate for these types of extra costs. In this case, Des Moines Blue Print bought a property that wasn't for sale. It needed the property for its expansion, so it was forced to bid more than what similar properties would have cost to persuade the owner to sell. The city appraised the building as if it had been for sale in an open market.

> Anytime government negotiates for a property and threatens to take the property by force if the seller doesn't agree to the terms, the price is neither a true market transaction nor fair to the seller.

By 2000, when Ainsworth and Strooh read about the city's plan in the newspaper, the color operation was still not making money. It was improving, and nine employees were working on the color side. But it was not yet profitable. "Everything hinges on the success of this color operation," Strooh said. "We had great dreams for 2000, and that's when we opened the newspaper and saw this plan."

About an hour after opening the newspaper, Strooh and Ainsworth were still sitting in the office dumbstruck. "We were still debating what it means to us," Strooh said. "Reality is setting in. Then these two sheepish-looking city employees appear at the door. . . . I still have this picture in my mind of those guys framed in the doorway peering around the corner, knowing they are going to walk into a hornet's nest. They said, 'We're from the city!' "

Strooh told them to have a seat. The officials then said: "Have you seen the newspaper this morning?" They told Ainsworth and Strooh they had until July 30 to get out of their building—a mere four months to move an entire manufacturing facility to another, yet-to-be-found location. "We were still quite numb," Strooh said. "It was like hearing you have a fatal disease and have only six months to live."

Ainsworth and Strooh thought it would be the end

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of the business. They were talking about selling out, closing up shop, laying off the 31 employees. Through an associate, Strooh found an attorney who specialized in eminent domain. Rather than fight the condemnation, as some property owners do, they focused on getting up and running at a new site.

The location they had was perfect for them. It was downtown, near most of their clients, had plenty of parking, and even had a drive-through window facing an alley, so clients could pick up their blueprints without leaving their cars. Yet they realized that those factors weren't really considered in the valuation. Des Moines Blue Print also learned that city officials had been planning to redevelop this part of downtown for several years and had quietly been paving the way for the process. For instance, Strooh learned, the city had lowered the property valuations in the area in 1998. Officials said they did this because the buildings were getting older.

Cities typically don't offer to lower tax valuations. The real goal, Strooh believes, was to lower the values of the properties the city intended to condemn. It's another example of the way government rigs the game in its favor.

> One of the problems with eminent domain is that city officials have no comprehension—or they don't care—about what is involved in building a business from scratch.

No Help in Relocation

Cities often boast that they will help targeted businesses relocate. This, as Strooh found out, was a complete joke. "The department of economic development came up with a list of properties, each one significantly more stupid than the last one. They listed properties that had the same square footage, but they were clueless about what we did. They are bureaucrats, anyway, so what did they care?" They were following the letter of the law—providing new options—but had no interest in helping the company find a new location that would actually work for it.

Consider the ridiculously tight time frame. In about four months the company would be forced from its location. But it did not know what the city was going to offer for the property. So the company didn't know how much money it would have for a new facility.

Des Moines Blue Print was denied due process under the law. Under due process, the company could have made the case as to why its property should not be taken. It could have explained the extent of the manufacturing operation that went on below the view of the aerial photographers whose pictures the city used to determine the right site to clear for an insurance company. It could have challenged the blight findings. Instead, the company found out about the project in the newspaper, after it was too late to object.

The appraisal game is strange. Most people figure that what the appraiser says is a fair approximation of what a property is worth. In fact, there are appraisers who specialize in working for cities and those who specialize in working for business owners. The city's appraisers can always be counted on to come in with a low figure. They know what to do if they want to continue to get lucrative work from the city.

Eventually the city offered $1,082,500 for the business; plus, under state law, the city had to pay the relocation costs. Des Moines Blue Print asked for $1.75 million. In Iowa, if the two sides can't come to terms, the matter goes before a board made up mostly of retired real-estate agents. "Especially here in Iowa, where they mostly appraise farms, and there's no hope that these board members would understand what we do," Strooh said.

It was a dicey situation. The city's offer was far too low—Des Moines Blue Print would never be able to get up and running on that figure. Besides not being fully compensated for the next-door building, the company was also not reimbursed for business "good will," the legal term for the intangible value of the business and its clientele. Often, businesses lose some of their clientele when forced to move to a different location, and "good will" is designed to compensate them for such losses.

It's hard to challenge the city. If the board comes up with a low offer and the business owner decides to appeal, the city goes ahead and takes the business, then

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deposits the offer in an escrow account until the matter is resolved. That puts the owner out of business essentially for about two years, since he cannot touch any of the money. The system is designed to avoid appeals, and only a wealthy owner can afford to float the entire worth of the company while the matter is battled in court. "You better be a wealthy business to appeal," Strooh said. "If you are a little guy and you hope to stay in business, you can't do it."

Negotiations End

After tense negotiations, the city offered $1.275 million, and Des Moines Blue Print decided to take it. Legal expenses generally are not reimbursed in such matters. Attorneys received about one-quarter of the difference between the city's original offer and the final, accepted offer. So about $48,000 went to the law firm, which comes right out of the business's final payment. As Strooh said, it's not cheap to get "just" compensation.

Through happenstance, the company found another building just outside the city's downtown. "We came out okay," said Strooh. "Len lost money initially, but the location has been good." The move made it tough for the company to weather the bad economic times following the September 11 terrorist attacks, but business eventually picked up at the new location.

"The frustrations and stress were incredible," Strooh said. "We had to buy a building without knowing what we were going to get. Plus, we had to deal with all the meetings. There were meetings with the city, meetings with appraisers, meetings with attorneys on a regular basis, meetings with realtors. . . . We were in negotiations all the time, plus we were trying to keep the old business going. This is a small company. Len and I are the only executives. Eminent domain says you must be made whole. But you don't have a leg to stand on. We did as well as we could, but it was the most difficult time in our lives."

It would be bad enough to put individuals through such stress and financial loss to make way for a highway or other public use. But this was done to make it easier for an insurance company to build a new building. Welcome to the world of eminent domain as it is practiced today—a process that is a far cry from what the Founding Fathers envisioned in the Fifth Amendment.

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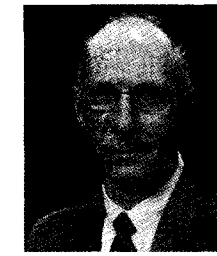
How the Western Cattlemen Created Property Rights



BY ROBERT HIGGS

During the last third of the nineteenth century, entrepreneurs created a vast open-range cattle industry in the Great Plains region of the United States. During the War Between the States, when Texas had been cut off from free-flowing commerce with the rest of the country, huge herds of cattle had built up on the state's open range. Being in great supply and limited demand, those cattle had little value in the Lone Star State, but entrepreneurs quickly perceived that they might realize substantial gains by collecting the cattle and driving them north, either to sell directly to farmers and miners or to place them on railroads for shipment to markets farther east. In pursuit of these opportunities, however, the cattlemen faced serious obstacles.

Courtesy of National Cattlemen's Beef Association

The Great Plains contained a vast expanse of lush grasslands, well suited for the support of cattle. Immediately after the war, however, millions of bison still occupied the area, along with numerous Indian tribes whose cultures revolved around using the big beasts as a source of meat, robes, and hides. Because bison proved unsuitable for domestication and no one possessed effective private property rights in the peripatetic creatures, they became a classic case of the "tragedy of the commons"—a common-property resource on the hoof that hunters had an incentive to kill so long as an animal had enough value to justify the marginal cost of killing it. In two decades, the bison were nearly annihilated.

At the same time, the standing army left over from the war dedicated itself to a series of Indian wars that decimated the Plains tribes and herded their remnants onto reservations where they posed no threat to the millions of whites who came to exploit the areas that the Indians formerly had occupied mainly for hunting and gathering. Still, even as the bison were slaughtered and the Indians dispossessed, the cattlemen had to surmount serious challenges to carry on their businesses successfully.

Because the area contained too little timber or stone to permit economical fencing (at least, until the introduction of barbed wire in the late 1870s), cattle belonging to different owners wandered over great distances and intermingled. To distinguish mine from thine, the cattlemen adopted the old Spanish practice of branding each animal with a distinctive mark to identify its owner. To make the branding system more effective, they established brand registries and supported enactment of territorial or state laws that required the use and inspection of brands. "Without a registered brand, ownership of cattle could not be legally transferred. If someone other than the registered owner had possession of a branded animal, that person had to have an appropriate bill of sale. The brand-registration system also provided for the sale of the brand itself."[1]

Still, even branded cattle intermingled on the open range, and each owner had to separate his animals from those belonging to others before he could sell them. To lower the collection costs, the cattlemen adopted the practice of district roundups, conducted cooperatively by cowboys from each firm stocking that

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part of the range: a spring roundup for branding the calves (according to the brands on their mothers) and a fall roundup to capture fattened animals for transport to market. Firms that refused to participate in the group roundup were excluded from relations with the other cattlemen—effectively ostracized for business purposes—which proved to be an effective noncoercive incentive for all-round cooperation. The threat of exclusion worked effectively because the conduct of a separate roundup by one firm, covering the entire range to collect its own animals, was too costly to be worthwhile.

Once the cattlemen had established their claims to individual portions of a district—usually by first occupancy and public announcement or by acquisition of legal title to a small area adjacent to the water source nearest a grassland—they formed associations to prevent overgrazing. These groups strove to prevent newcomers from entering an already-occupied range, to keep the existing occupants from overstocking it, and to ensure that each firm provided bulls in sufficient quantity and quality to bring about the healthy reproduction of the herds.[2] Such associations were formed throughout the cattle-raising areas of the Great Plains, Rocky Mountain states, and territories from Kansas and New Mexico in the south to North Dakota and Montana in the north.[3]

"Range Already Overstocked"

For example, in 1883 an association operating on the Musselshell range in east-central Montana published a description of its range in the Helena *Daily Herald* and stated: "We the undersigned, stock growers of the above described range, hereby give notice that we consider said range already overstocked; therefore we positively decline allowing any outside parties or any parties locating herds upon this range the use of our corrals, nor will they be permitted to join us in any roundup on said range from and after this date."[4]

The cattlemen's associations also organized efforts to keep rustlers at bay "by patrolling the range and hiring stock detectives who tracked down thieves."[5] They took matters into their own hands because, as one rancher stated, "the civil laws in courts had been tried and found wanting."[6] Thus did privately organized institutions provide for the effective protection of property rights—a function that some analysts still mistakenly believe only government can accomplish.

> Western cattlemen had to surmount serious challenges to carry on their businesses successfully.

As hordes of farmers spread across the Great Plains, and the U.S. government enforced the homestead law and made other land dispositions in conflict with the rights that the cattlemen had established, the open-range cattle industry faded into historical memory. As portrayed in countless stories and movies, the industry involved anarchic conflict and rampant violence, a depiction untrue to historical reality for the most part. As Terry L. Anderson and Peter J. Hill have written, "Unlike the imagined wild and woolly region where the fastest gun or the biggest landowner exploited everyone else, the real West was generally peaceful because of the stable institutional environment that was carved out by the early pioneers."[7]

1. Terry L. Anderson and Peter J. Hill, *The Not So Wild, Wild West: Property Rights on the Frontier* (Stanford, Calif.: Stanford University Press, 2004), p. 149.

2. Ibid., pp. 148–56, 160–66.

3. R. Taylor Dennen, "Cattlemen's Associations and Property Rights in Land in the American West," *Explorations in Economic History*, October 1976, pp. 426–28.

4. Cited ibid., p. 427. Anderson and Hill, p. 165, quote a similar announcement published in 1886.

5. Anderson and Hill, p. 151.

6. Quoted ibid.

7. Ibid., p. 202.

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Hypnotized by Models

BY GENE CALLAHAN AND ROBERT P. MURPHY

We live in an age where abstract models of the real world are held in high regard. Wall Street firms hire mathematicians and physicists to create sophisticated mathematical representations of various assets and markets. Meteorologists employ computer simulations in an attempt to anticipate the path of storms and predict next week's weather. Marketing firms try to model how consumers will respond to a proposed ad campaign. Military strategists conduct virtual battles and wars. Bridges are built, planes are flown, giant buildings are raised, and crops are planted with the aid of abstract systems of equations.

The current respect for abstract modeling is not unfounded. Ever since the scientific revolution that took place during the sixteenth and seventeenth centuries, mathematical models of the physical world have continually increased humans' ability to manipulate their environment. On the other hand, repeated attempts to port the mathematical techniques that have proved so successful in the physical sciences directly to the social sciences have produced few positive results to date. But those who view the current methods of the physical sciences as the *only* valid way to achieve objective knowledge have claimed that this record of failure is due entirely to the relative youth of the social vis-à-vis the physical sciences and the greater complexity of their subject matter. Given enough time, they contend, mathematical models will depict the behavior of individuals and the evolution of social phenomena just as well as they handle inanimate matter and energy today.

For the time being we will set aside the question of whether those who contend that true social science *must* be based on mathematical modeling have a rational or empirical case for their stance. Instead, we will first point out that, for anyone engaged in the fascinating project of creating and perfecting abstract models, it is easy to forget that however useful and sophisticated his models might be, they are still only skeletal images of some subset of a complete human experience. Watching a simulation of a hurricane on a computer screen is a far cry from actually being in the midst of one. The chaos that ensues once a real battle is underway is never captured in a model of the conflict. A mathematical description of the atmospheric refraction of light at sunset does not convey the power of the setting sun as a metaphor for old age and death, the wistful nature of a winter sunset on a lonely moor, or the romantic mood created by watching the sun sink into the sea as one stands with a lover on a desert isle's beach.

However useful models might be, they are still only images of some subset of a complete human experience. Watching a simulation of a hurricane on a computer screen is a far cry from being in the midst of one.

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Correctly interpreting the relationship between a model and the raw experience from which it was abstracted is a matter of skilled judgment. A model cannot interpret itself; it asserts that *if* certain aspects of a particular situation closely conform to specifications contained in the model, *then* we can expect certain other circumstances to arise, either with full certainty or with some measure of probability. The question of how well a model captures the essence of some event in the real world cannot be answered mechanically.

All this implies an important pragmatic point about the application and misapplication of models: Skill at developing and manipulating the abstractions comprising a model does not necessarily correlate to skill at interpreting how that model relates to reality. Someone who is extraordinary at modeling various investment opportunities may be a disaster if he actually trades the securities he has modeled, which is why investment banks employ experienced traders to put their models into practice. A person who can develop top-notch simulations of the potential battle scenarios might be awful at responding to the constant surprises presented by a real battle, which is why armies have experienced officers in charge of their troops during an actual conflict.

Among economists, it is the Austrians who have been most keenly aware of the difference between being good at creating models and being good at interpreting their application to real events. They have noted that mainstream economists frequently develop highly simplified models of some economic process and then proceed to criticize the real economy because it does not perform like their model.

Perfect Competition

The model of perfect competition (PC), a mainstay of introductory economics courses, is a notable example of that tendency. The "competition" it depicts is deemed "perfect" because it leaves no unexploited gains from trade; for given technology, resources, and consumer preferences, there's no way to make any one person better off without harming someone else. However, in order for selfish decision-makers to be led by the "invisible hand" to this collectively efficient outcome, the model of perfect competition requires that neither the buyers nor the sellers of a good can affect its price. Instead, the model treats them as "price takers," passive entities who merely accept a price that emerges from mathematical equations. If the supply or demand for the good changes, its new price is automatically and instantly produced by the model. Should the demand for a good drop, all people selling it will suddenly discover, to their surprise, that they are now offering it for less! Somehow the price displayed on the sign on their shelf and in their newspaper ads will be changed by the supply and demand curves. Perfect competition is perfectly impossible, since it pictures a "market" in which human action, the driving force of all markets, is entirely absent.

But even if we set that aside, there is still a serious problem with the internal consistency of perfect competition. (This was first noted by mainstream economist G. B. Richardson.[1]) The model assumes that all market participants have identical knowledge of all economic conditions. Therefore, in response to a higher-than-normal return in the market for some particular good, all of them will be motivated to become suppliers of the good. However, their mass entry would result in a large increase in the supply of the good and a below-normal return. Since they all can anticipate the potential flood of new entrants, they will all be equally discouraged from supplying the good. But that leaves the return to the current suppliers above normal, spurring everyone to jump into the market, which would reduce the return to below normal, prompting everyone to stay on the sidelines . . . well, you can see where this is going. There are several potential assumptions that might be added in an attempt to rescue the model, but none of them is remotely realistic.

Despite all we have said, we don't suggest consigning the notion of perfect competition to the theoretical scrap heap. Even though it is highly unrealistic, it accurately depicts a particular, limiting case, which is implicit in the general analysis of supply and demand. Contemplating it may promote genuine economic insights. But we should keep in mind that it *is* an artificial construct, highlighting one aspect of the market process, at the high cost of pretending that there could *be* a market without the efforts of human

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actors to adjust prices so that they better reflect prevailing conditions and preferences.

Yet what has the mainstream done with perfect competition? Rather than use the internally inconsistent model as a flawed but occasionally useful thought experiment, the typical economist uses its unrealistic (and indeed nonsensical) assumptions as a *benchmark* against which to judge the actual market economy. In particular, whenever firms in the real world engage in behavior that would be counterproductive in a PC model—and this includes such ostensibly consumer-friendly behavior as slashing prices and introducing new features to distinguish a product from its rivals—then this merely proves that the firms in question have "market power" and hence are not using resources efficiently. As F. A. Hayek said, "[I]f we ask which of the activities that are commonly designated by the verb 'to compete' would still be possible if [the conditions of perfect competition] were all satisfied . . . I believe that the answer is exactly none."[2]

> The politician eager for votes can always find some model to justify politically popular policies.

In addition to the model of perfect competition, we recently ran across a similar example in a textbook on international economics. Discussing the relationship of a nation's exchange rates to its balance of payments, the author says, "[U]nder a flexible exchange rate system, a balance-of-payments disequilibrium is *immediately* corrected by an *automatic* change in the exchange rates. . . ."[3] (Note that the author simply means the market will eliminate "gluts" and "shortages" of various *currencies* as surely as of commodities like milk and eggs.)

Now if a disequilibrium is "immediately corrected," in what sense did it ever exist? Wouldn't a market have to be out of equilibrium for at least *some* time, however brief, before we could say that there was any disequilibrium? The author's problem is that in the model he is using, exchange rates are always in equilibrium. He recognizes that real-world rates *must* be out of equilibrium at times—otherwise, why would any rational investor ever enter the foreign-exchange market?—but his model only deals with states of equilibrium. Therefore, he is forced to posit disequilibria that vanish simultaneously with their appearance.

And how would exchange rates change automatically? Is there a god of foreign exchange, attuned to the equations in textbooks on international economics, acting to enforce those formulas? In reality, isn't it when traders in the foreign-exchange market believe that an existing exchange rate is, in some sense, "wrong" that they make trades resulting in an alteration of the rate? In markets as liquid as the dollar-yen or dollar-euro, we might expect that such adjustments will occur very rapidly, so that reality will not be too different from a model in which they are instantaneous. Still, that does not make them automatic.

Models Can Be Useful

We could offer many more examples, but the two described above should be sufficient to illustrate our point. Again, we are not contending that all such models be banned from economics. Even those economists who disdain "unrealistic" models almost certainly give illustrative examples to their undergraduate classes in which, say, prices are rounded to the nearest whole dollar (even though this rarely happens in the real world). And what economist hasn't resorted to analyzing capital accumulation by picturing Robinson Crusoe, or analyzing international trade by considering a world with only two countries, each of which produces only one good?

However, to pass judgment on existing markets based on how closely they approximate an abstraction dreamed up by some theorist is to egregiously confuse the map and the territory. Even the most devout model builders will admit that their simplifying assumptions are acceptable *only if they do not lead one to an erroneous conclusion*. As David Romer—macroeconomist and author of textbooks that are *full* of models—puts it:

> [T]he purpose of a model is not to be realistic. After all, we already possess a model that is completely realistic—the world itself. The problem with that "model" is that it is too complicated to

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> understand. A model's purpose is to provide insights about particular features of the world. If a simplifying assumption causes a model to give incorrect answers *to the questions it is being used to address*, then that lack of realism may be a defect. . . . If the simplification does not cause the model to provide incorrect answers to the questions it is being used to address, however, then the lack of realism is a virtue: by isolating the effect of interest more clearly, the simplification makes it easier to understand.[4]

At first, Romer's stance seems perfectly sensible. But in practice, his method contains an implicit bias toward government intervention. What has happened time and again is this: A macroeconomist devises a model in which the free market "fails," which is to say, the equilibrium outcome in the model is not "Pareto efficient." This is simply a fancy way of saying that the macroeconomist can formally show us that there is an alternative state of affairs (in his model!) in which every person in the economy (in the model!) could be made better off. The macroeconomist then takes this result and recommends that the government enact a certain policy to "correct" the market failure.

Now how is the free-market economist supposed to combat this? Of course, he can point out that the model used to justify the government intervention is unrealistic—but such an observation will be met with amusement by the likes of Romer. The free-market economist can come up with a *different* model, in which the recommended policy will lead to disaster. But then what? The typical macroeconomist has *his* model that recommends intervention, while the free-marketer has *his* model that advises laissez faire. How to decide? By Romer's stated criterion, we need to know which model's abstractions are harmless and which give us a false conclusion. Unfortunately, *that is precisely what the models themselves cannot tell us*. In practice, politicians tend to go with the activists, because at least then the public thinks "something is being done." And if it turns out to be a disaster, well, the macroeconomists just return to the drawing board and try to figure out a slightly *different* way to tinker with the economy. And, as history has shown time and again, the laissez-faire economists are at every step labeled "dogmatic," do-nothing cynics who are unwilling to experiment.

The modern fascination with models has influenced economics no less than other fields. Used properly, abstract models can often shed light on complex phenomena. Unfortunately, this practice has caused far more harm than good when it comes to the social sciences. Part of the problem is the qualitatively different subject matter: the physicist and chemist study inanimate matter, while the economist studies acting, self-aware beings with subjective desires and intentions. Another issue is simple duplicity: the politician eager for votes can always find *some* model to justify politically popular policies.

But perhaps the biggest flaw with current modeling techniques is their crudeness. The heroic simplifications necessary to make economic models "tractable" would be truly astonishing to those who assume the brain trusts at MIT and Chicago hold their financial future in good hands. For example, the baseline macro models taught at top-rank Ph.D. programs still feature economies with one good (which serves as both capital and consumption) and one consumer who lives forever and has perfect foresight. And yes, it is because of analysis based on such models that "expert" economists will recommend certain fiscal or monetary policies. Scary, isn't it?

1. See Gerald P. O'Driscoll and Mario Rizzo, *The Economics of Time and Ignorance* (London and New York: Routledge, 1996 [1985]), pp. 90–91.

2. F.A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), p. 96.

3. Dominick Salvatore, *International Economics* (Hoboken, N.J.: John Wiley & Sons, 2004), p. 512, emphasis added.

4. David Romer, *Advanced Macroeconomics* (New York: McGraw-Hill, 1996), pp. 11–12.

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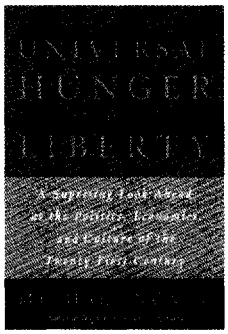
Book Reviews

The Universal Hunger for Liberty: Why the Clash of Civilizations Is Not Inevitable

Michael Novak

Basic Books • 2004 • 281 pages • $26.00

Reviewed by Richard M. Ebeling



The free society is a frail and demanding institutional order. It requires that men resist the temptation to violate the freedom of others who may act and speak in disagreeable or fundamentally wrong ways. It is far easier to advocate or use force to prevent them from doing so. To get others through noncoercive means to behave or think differently requires one to cultivate the art and patience of persuasion. It implies not only a belief in, but also a willingness to practice, reason over compulsion.

Freedom also requires the will to resist using force to obtain what others have. The free society demands that we each renounce the use of violence and fraud in our relationships with others. When others choose to buy from someone else rather than us, freedom demands that we not turn to government to make them do what they do not want to do.

Throughout most of history the price of freedom has been more than many have been willing to pay. Intolerance and dogmatism have straitjacketed men's minds and deeds. At the same time, government power has been placed, over and over again, at the service of those who want to plunder their neighbors rather than associate with them peacefully and consensually.

Human history is also the tragic story of brutality, cruelty, and frequent mass murder in the effort to stifle "dangerous" or "heretical" thoughts and actions, to eliminate scapegoats, and to steal from others. How easily many men have become the willing or passive accomplices in the destruction of the lives and fortunes of others!

It is therefore worth asking if Michael Novak is right when he titles his new book *The Universal Hunger for Liberty*. The impetus for Novak is the question whether Western civilization is irreconcilably in conflict with the Islamic world. He emphasizes the unique properties in Western culture as it has developed over hundreds of years: the importance of reason in understanding the world and its application to the mastery of material existence; an appreciation and respect for the dignity and sanctity of the individual and an accompanying belief in a higher law than that of man which has grown out of the Judeo-Christian heritage; an allegiance to the rule of law and checks on political power to protect the freedom of every individual; an optimism about life and the future of the human condition that fosters innovation, risk-taking, and economic and social change for a better tomorrow; and an understanding that neither freedom nor prosperity can be maintained or expanded without private property and freedom of enterprise.

Over a series of chapters, Novak articulates the arguments and facts that demonstrate these unique and crucial qualities that have created what we call "the West." He does so, very often, with great clarity and eloquence. Arguably, his purpose is not only to show how "we" may differ from or have various commonalities with other societies and cultures, but also to remind Western readers (including and especially in the United States) what has made the freedom and prosperity that we enjoy.

As historian Robert Conquest has warned in his new book, *The Dragons of Expectations: Reality and Delusion in the Course of History*, those things that have made Western society (especially America and Britain) great have been and are being eaten away from within by ideological elites and political-economic plunderers who are undermining the morality and institutional order on which our system of liberty and law has been based.

While Novak compellingly shows that many of the outer trappings of Western society are being "globalized," particularly in formerly socialist countries, it is far from clear that the ethical, cultural, and religious underpinnings that produced liberty and limited government in the West are as rapidly becoming part of the everyday consciousness of people in other parts of the world. The apparent spread of "democracy" in many countries is not the same thing as the expansion

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of the culture and morality of liberty. The latter takes several generations before it becomes a "self-evident" element in the thinking and attitudes of men—and its precariousness at times of "national crisis" has been shown more than once in the Western world itself.

Thus when Novak tries to explain and interpret the possibility of freedom in the Islamic world, he acknowledges that traditionally the autonomy of the individual has never been as respected there as it is in the West. And he can merely suggest ways in which traditional Islam may continue to evolve in directions that will make it compatible with the central tenets of Western civilization if moderate and "enlightened" voices increase in number in opposition to the radical extremists.

But the direction of history cannot be accelerated by force—too often when it has been tried, it has generated disaster. It would be wiser if we in the West devoted a good portion of our time to getting our own political, economic, and cultural house in order before liberty at home is threatened beyond repair. That would be the finest and most effective stimulus for freedom that we could contribute to the rest of the world.

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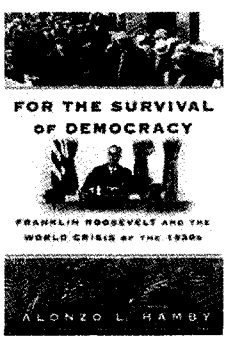
For the Survival of Democracy: Franklin Roosevelt and the World Crisis of the 1930s

by Alonzo L. Hamby
Free Press • 2004 • 492 pages • $30.00

Reviewed by Burton Folsom, Jr.



The latest New Deal synthesis is *For the Survival of Democracy* by veteran historian Alonzo Hamby of Ohio University. What makes Hamby's research design different is that he describes the development of Franklin Roosevelt and the New Deal in an international context. Specifically, he weaves the American narrative with events in Britain and Germany in the 1930s.

Hamby is at his best developing the characters of Churchill, Stanley Baldwin, Hitler—and of course those New Dealers who surrounded President Roosevelt. His brief biographies help make the book readable and interesting.

In interpretation, Hamby's book is a bit of a puzzle. He does not fully accept the laudable accounts of Roosevelt that have dominated American historiography; but neither does he really reject them. He concedes that the New Deal failed to improve the American economy, but he finds Roosevelt to be a capable president. "Reduced to paper," Hamby concludes, "the Roosevelt record was hardly impressive. . . . But Roosevelt was impressive. His charisma, rhetorical talents, and dynamism made the New Deal more than the sum of its parts." Such separating of the President from his record is strange, but it is a step up from exalting *both* Roosevelt and his record (which is more consistent, but wrong on two counts, instead of just one).

Part of the problem here may be Hamby's weakness in economic analysis. "Whatever else the [Roosevelt] administration had done," Hamby observes, "however many benefits it had delivered to Americans, it had not ended the Depression." When Hamby says this he seems surprised—as though New Deal programs clearly delivered "benefits" but did not inflict costs as it did so.

Henry Hazlitt, a *New York Times* columnist during the 1930s, repeatedly reminded Americans that whenever a New Deal program conferred cash on a lucky recipient, it had to secure the cash from an unlucky taxpayer. Thus all jobs created by the WPA, CCC, or PWA took capital from consumers that could otherwise have been used to build factories or to buy sweaters or radios or paint for the house.

So when Hamby asks, "Did not governments engage in a social good by giving employment to those who needed it?" the answer is not "yes," as he implies, but "maybe not," because cash given to employ, say, street pavers in Ohio lost the chance to employ radio makers in New Jersey or textile workers in South Carolina. In other words, jobs were merely transferred from one group to another.

What this means in terms of analyzing policy is that when Hamby writes in one paragraph that the federal subsidy to veterans in 1935 "pumped about $2 billion into [the] economy," maybe he should let the reader

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see in the next paragraph that a tax hike that same year raised the tax rate on top incomes to 79 percent (four years earlier, the top rate had been only 24 percent). The two events need to be discussed together because they function together. Hamby discusses the programs, but rarely bothers with the taxes that transferred the money out of taxpayers' pockets to pay for them.

The task of those who would defend Roosevelt and the New Deal is to address these transfer payments with all of their ramifications. When Hamby concludes, "The WPA would endure until 1943, doing far more good than harm," he should explain why Americans were allegedly better off with the WPA and higher income taxes and higher excise taxes on cigarettes, tires, bank checks, movie tickets, and telephone calls than they would have been with no WPA and lower income and excise taxes.

According to the *League of Nations World Economic Survey 1938/39*, the recovery rates from the Great Depression were much better in France and Britain than in the United States. In 1938 U.S. unemployment, which was barely under 20 percent, was higher than France's 8 percent and Britain's 12.6 percent. In that international context, Roosevelt's New Deal seems to be less, not more, than the some of its parts.

Nonetheless, *For the Survival of Democracy* is a step forward because Hamby, a mainstream historian, is willing to criticize much of the New Deal and some of Roosevelt's actions and motives. In his bibliography, he even praises Gary Dean Best, whose book *Pride, Prejudice, and Politics* is the best modern critique of the New Deal that we have. As we move away from the New Deal era, the quality of history written about it is beginning to improve.

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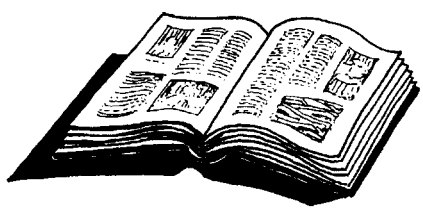
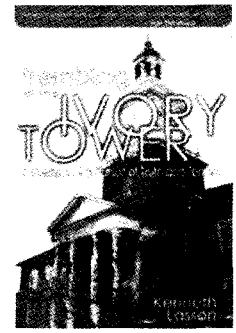


Trembling in the Ivory Tower: Excesses in the Pursuit of Truth and Tenure

by Kenneth Lasson

Bancroft Press • 2003 • 196 pages • $22.95

Reviewed by George C. Leef



If you listen to spokesmen for the higher-education establishment, America's colleges and universities are the envy of the world, propelling our economy forward with brilliantly educated young minds. Look only at the bright spots in American higher education and you might well conclude that such praise is merited. But to assume that something is true of the whole because it is true for some of the parts is fallacious—the fallacy of composition. That's pertinent here. Just because our universities turn out world-class scientists and engineers doesn't mean that our higher education *system* is world-class.

Beneath its lovely façade, there's a great deal of decay in American higher education. At many schools, the curriculum is feeble and academic standards have sunk out of sight. The paramount concern of administrators and professors is keeping the students happy—the "beer and circus" syndrome, as Murray Sperber calls it.

And then there is the problem of the intellectual climate. Thanks to the mania for "diversity" sweeping through American higher education, we've reached the point where many ideas can no longer be discussed because someone in a "protected group" might be offended. It is mainly to this degradation of academic discourse that *Trembling in the Ivory Tower* is addressed. Kenneth Lasson, a professor of law at the University of Baltimore, finds that our colleges and universities are becoming increasingly hostile to intellectual freedom, their focus changing from open debate and inquiry to ensuring that students come away from their college years with "correct" attitudes.

Lasson's book is chock full of evidence that things have gone badly awry. Students now typically graduate "with inferior backgrounds in the humanities, weak language and writing skills, and little respect for their professors." One reason they have little respect for their professors is that the professors don't do much to

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earn it. Increasingly, they're preoccupied with their "research"—that is, writing articles and books that help them obtain tenure and higher pay. Teaching plays second fiddle. That's bad enough, but Lasson regards most of the "research" to be drivel. An incredible number of specialized academic journals filled with pretentious and impenetrable writing are produced every year to no purpose other than resumé padding.

Worse still, in many academic disciplines the radicals of the '60s and '70s have taken control and insist on turning their courses into platforms for the propagation of their ideology. Radical feminists are among the worst culprits in that regard. "Good people of both sexes have been stampeded into corners of stilted parlance and tortured logic by the self-appointed thought police," Lasson writes, "Big Sister has imposed herself upon all of us." The "radfems" don't just hold sway in the almost ubiquitous "Women's Studies" programs, but have also unleashed their embittered view of the world in English, sociology, and other fields. They have succeeded not only in poisoning the minds of some students, but also in poisoning campus discourse.

And if radical feminism has eroded the foundations of higher education with its acid, the "diversity" movement has attacked those foundations with jackhammers. Students and professors are harassed with speech codes and "diversity czars" who are eager to find bigotry, discrimination, or mere "insensitivity" everywhere. "Instead of blending ethnicity fairly into a melting pot, we have allowed multiculturalism to boil over into a seething cauldron of conflict," Lasson rightly observes. Here's an example he gives.

A group of students launched a protest in 1999 at Berkeley, demanding an increase in the number of faculty members in the school's Ethnic Studies Department—even though the department had low enrollment. More than 100 students were arrested after they took over a campus building, but the administration caved in when six of them went on a hunger strike. It agreed to hire eight new full-time faculty members, to provide funding for an Institute of Race and Gender Studies, and to pay for a mural depicting the student takeover.

What can be done? Most of the book is devoted to the explication of the problem, and Lasson doesn't do much to show the way out of the morass. "If eternal vigilance is the price of freedom," he writes, "then we must be especially alert that the trustees of the academic enterprise are forever honest in perpetuating the vigorous exchange of ideas, values, and convictions . . . and that they are consistent and critical in their pursuit of truth." Yes, of course, but those trustees are the very people who have looked on with indifference as the academic degradation proceeded apace. Why expect them to arise from their torpor?

Even if Lasson doesn't have a solution at hand—and I don't think anyone does—he has done a superb job of identifying the problem. His witty and engrossing book is must reading for everyone concerned about higher education.

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Government Failure: E. G. West on Education

Edited by James Tooley and James Stanfield
Institute of Economic Affairs • 2003 • 201 pages
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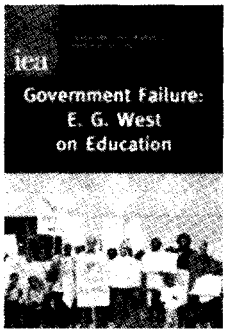
Reviewed by Antony Flew



This illuminating book was designed to commemorate the achievements and to spread the ideas of the late Edwin G. West. Professor West, who lived from 1922 to 2001, did pioneering work in the economics and history of education, and his studies have been critical in refuting the pretensions of government education. Those who wish to show that government fails to educate students well and to restore a free market in education will find that E.G. West was one of their greatest allies.

Gathered here are nine of West's essays on education. Professor James Tooley, who has made great contributions to the debate over government-provided education himself, writes in his introduction that he initially approached West's work with the intention of refuting it. As he read and thought about West's arguments, however, he found himself being won over. "For

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me, the fact that governments rightfully intervened in education was a taken-for-granted norm—so taken for granted that it didn't really come up in discussion," he writes. "Any deviance from the status quo—such as moves towards markets in education—needed to be justified, not state intervention itself. E.G. West's argument threatened to completely overturn this cosy presumption."

West's first discovery—still normally ignored in schools, departments, and institutes of education—was that, before the Forster Act of 1870 established the first tax-funded schools in England and Wales, school attendance and literacy rates were well above 90 percent. The educational situation in the United States at roughly the same time seems to have been sufficiently similar for Milton and Rose Friedman, while they were working on their book *Free to Choose*, to change their minds about government compulsion and funding by examining the works of West. Friedman would later recommend that the Hoover Institution give West the first Alexis de Tocqueville Award for the Advancement of Education Freedom. Friedman himself made the presentation.

West's wider international influence appears to have been greater than his effective influence on either the United Kingdom or the United States. The movement toward educational choice in America has been minimal, owing to the vociferous opposition of the education establishment to any movement whatever away from the status quo. In Britain, under the government of John Major, a limited voucher system known as Assisted Places was established, but, as the editors appear to have overlooked, it was immediately abolished by the incoming Blair administration in 1999.

The prime evidence of West's wider influence is provided by the fact that he was commissioned to produce, and duly produced, two papers for the International Finance Corporation (IFC, the private finance arm of the World Bank). Those papers were entitled "Education with and without the State" and "Education Vouchers in Practice and Principle: A World Survey." They actually succeeded in persuading the IFC and World Bank to revise their education policy to favor a greater role for the private sector.

Much of West's work was focused on the economics of politics (or Public Choice economics, as it is now called). As he said, "Benevolent government does not exist. The political machinery is . . . in fact, largely . . . operated by interest groups, vote-maximizing politicians and self-seeking bureaucracies." As the writings of Myron Lieberman have taught us, the teachers unions are among the most powerful of such "self-seeking bureaucracies." West led the way in demonstrating the utter folly of expecting good educational results from a system dominated by the producers rather than the consumers of education services.

A particularly fascinating contribution in the current volume is chapter 5, "The Economics of Compulsion," in which West used his knowledge both of history and Public Choice economics to show that the compulsion to attend school has never been a major cause either of increased school attendance or any general improvement in human behavior.

The final essay in the book, "Education without the State," speculates as to how much better off education consumers would have been if Britain had not taken the steps to establish universal tax-supported schooling. He concludes with these words of advice, "The choice of school movement, it is maintained, has been to a large extent misinformed. What is needed is choice in *education*."

The work of E.G. West is being continued by the E.G. West Centre, based in the school of education at the University of Newcastle. Established in 2002, the Centre is the only university research center in the United Kingdom dedicated to developing market solutions in education.

Those who seek to move away from the government-schooling monopoly, whether in the Britain, America, or elsewhere in the world, will find this book to be of enormous value.

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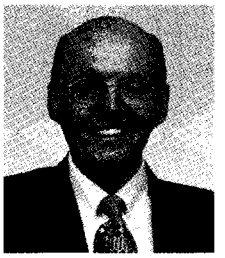
Henry Hazlitt on Unions: Part II



BY CHARLES W. BAIRD

In my last column (November) I discussed Henry Hazlitt's views on the economic effects of unions, exclusive representation and mandatory bargaining, labor's alleged bargaining-power disadvantage, and the right to strike. Here I will discuss three other aspects of Hazlitt's views on American unionism: involuntary unionism, government-employee unionism, and what he called the "Grand Illusion" of labor solidarity.

Involuntary Unionism

Correctly understood, freedom of association is each person's right to affiliate with any group pursuing legal ends that is willing to associate with him. Logically, this implies that each person is free to abstain from affiliation even if the group is eager for him to join. American unionism under the National Labor Relations Act is not based on freedom of association because where there is a certified union, individual workers may not abstain from associating. Moreover, American union law violates employers' freedom of association by mandating good-faith bargaining. American unionism is involuntary unionism. Hazlitt put it this way:

> In accordance with the principle of freedom of peaceful association, the law should not prohibit unions, but neither should it go out of its way to encourage them. Certainly the government should not continue, as it does in the United States, to turn itself in effect into a union-organizing agency and to force employers to negotiate with unions.[1]

"In accordance with the principle of freedom of peaceful association, the law should not prohibit unions, but neither should it go out of its way to encourage them."

— HENRY HAZLITT

Voluntary unions would, according to Hazlitt, have legitimate functions to perform:

> There are, no doubt, areas in which the activities of unions, wisely directed, could be on the whole beneficent—in negotiating with individual employers, for example, concerning hours of work and such conditions of work as light, air, sanitary arrangements, rest rooms, coffee breaks, shop rules, grievance machinery, and the like.[2]

In 1946 he stated that the legitimate functions of voluntary unions would include assuring "that all of their members get the true market value of their services."[3] That is, any worker who felt that he wasn't being paid the full value of his services should be free to designate a willing union to bargain for him with an employer who was willing to bargain. He then went on to state that it is highly unlikely that most workers would be in such a situation because underpaid workers are a profit opportunity for other employers to bid wages up.

Government-Employee Unionism

Hazlitt thought that the principle of freedom of association also justified voluntary government-employee unions. However, he advocated strict limits to the scope of collective bargaining in the government sector.

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> They [civil servants], like private employees, should not be prohibited from joining unions. They, too, should enjoy the right to freedom of peaceable association. But no government unit for which these public employees work should be under any legal obligation whatever to recognize or negotiate with such unions. . . . It is . . . an absurdity for the public authorities to make agreements or "contracts" with these unions. The terms of employment should be set by the government directly with the individual employee.[4]

Hazlitt also held that third-party arbitration was never proper in the government sector.

> If the government authorities "bargain collectively" with unions, and if the union leaders refuse to accept the final terms offered, must the authorities then turn to third parties and let *them* decide the terms? The elected representatives of the people have been elected to make these decisions. They cannot delegate them to private "arbitrators," or be overruled by them. It is they, and they alone, who must take final responsibility for whatever terms of employment are set.[5]

Hazlitt held that "No public employee has the right to strike." He quoted Calvin Coolidge to make the point: "*There is no right to strike against the public safety by anybody, anywhere, any time.*"[6]

The "Grand Illusion" of Labor Solidarity

Unionists contend that all workers have interests in common against employers, and that every worker is therefore duty bound to honor all picket lines and to join labor unions. In fact, as Hazlitt eloquently explained, unionism almost always pits the interests of some workers against other workers, both as workers and as consumers. In *Economics in One Lesson* he constructs an arithmetic example, assuming that all workers are unionized, to illustrate the logical fallacy of labor solidarity.[7] His argument is based on relative real wages. Space does not permit me to quote him here, but I commend it to you. In 1973 he summed up his thinking on this issue:

> Once it is clearly recognized that the strike-threat gains of each union are at the expense of all other unions in forcing their members to pay higher prices for products, the whole myth of "labor solidarity" collapses. It is this myth that has kept the strike-threat system going. . . . The mass of the working population has been taught to believe that all workers should support every strike . . . to "respect the picket lines" because "Labor's" interests are unified. The success of any strike is thought to help all labor and its failure to hurt all labor.

This is the modern Great Illusion. In fact, each union's extorted "gains" by raising a specific industry's cost and therefore its prices, reduces the real wages of all other workers. The interests of the unions are mutually antagonistic.[8]

In 1971 Hazlitt wrote that employers should not be allowed to discriminate, in hiring, against workers on the basis of their affiliation or nonaffiliation with a union.[9] In my view, truly voluntary unionism implies that employers must be free to operate on a union-only or union-free basis. The market will sort out what works from what doesn't work on a case-by-case basis. Hazlitt agrees with Hayek on the point,[10] so I guess I shouldn't be too dismayed.

1. Henry Hazlitt, *The Conquest of Poverty*, Chapter 13, "How Unions Reduce Real Wages" (New Rochelle, N.Y.: Arlington House 1973), pp. 141–42.

2. Ibid., p. 141.

3. Henry Hazlitt, *Economics in One Lesson* (New York: Arlington House Publishers, 1979 [1946]), p. 141.

4. Henry Hazlitt, chapter in *The Strike: For and Against* (New York: Hart Publishing Co., Inc., 1971), pp. 80–81.

5. Ibid., p. 81, emphasis in the original.

6. Ibid., emphasis in the original.

7. *Economics in One Lesson*, pp. 143–45.

8. *The Conquest of Poverty*, pp. 135–36.

9. *The Strike*, p. 78.

10. F.A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1962), p. 278.

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